COMPETITION POLICY AND INSTITUTIONAL REFORM IN LATIN AMERICA

EXPLORING THE INSTITUTIONAL FOUNDATIONS FOR ECONOMIC GROWTH IN DEVELOPING COUNTRIES.

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ABSTRACT

Until recently, institutional reforms implemented under the so-called "*apertura*" economic strategy had emphasized the correction of macroeconomic imbalances through specific policy measures (i.e., privatization, open trade, fiscal balance, stable exchange rates). As overall imbalances have been corrected, policy makers are considering the introduction of a second generation of "institutional reforms". Consequently, the focus of reform would shift into the promotion of productivity, competition, and innovation at the entrepreneurial level. These institutional goals presuppose a new regulatory framework, amenable to market functioning. Antitrust policy is one example among many regulatory initiatives being advocated to support market reforms.

This thesis shows how the broad misconceptions about the nature of markets still pervades policy-making throughout the region. Antitrust policies could threaten to reproduce, under powerful new forms, the former interventionism that characterized "development" policies of the 1960s and 1970s. Paradoxically, this interventionism would be justified in the name of preserving market transparency.

Advocates of antitrust policies often share a subtle anti-market bias: Markets are regarded structures, where density of concentration determines how competitive they are. Following the welfare implications drawn from the neoclassical models of equilibrium, economic exchange is examined under severely constrained conditions: individuals are assumed to possess complete information and transactions are "timeless". The aftermath of this perspective is that all business arrangements are regarded "restrictions to competition", some of these suspected of sheltering monopolistic purposes.

The effects of these policies in the region could be particularly harmful in Latin America, as businesses interacting in the domestic markets of the region have developed over time numerous forms of unofficial institutional devices, most of them addressed to complement the lack of transparency of the enforcement of the official legal framework. In the wake of *apertura*, these institutional devices, coupled with high levels of economic

concentration, appear to favour monopolistic conducts, but in fact they attempt to correct the adverse effects of decades of *dirigisme* and uncertainty of a stable rule of law upon business activities.

Latin markets are undergoing a fast transformation since *apertura* began. Due to the lifting of trade regulations, there is a significant wave of mergers and acquisitions, privatization processes, setting up joint ventures, selling undervalued assets, and proliferation of new corporate forms and other forms of efficient association reshaping old inefficient structures and replacing them with new ones. Young Latin American antitrust agencies have already challenged many of these undertakings as sheltering some form of monopolistic endeavor.

Under a perspective emphasizing the evolutive nature of market interaction, these conducts appear simply as modalities by which the economic knowledge of each market participant is passed on to others in the system. These seemingly monopolistic attempts are in fact efficient arrangements allowing businesses to plan in advance their activities relating to conjectural future business scenarios. These arrangements sometime encourage mergers, vertical integration, and even collusion, but they are also responsible for new market discoveries, innovation and increased production. To support this conclusion, this thesis is supported on the heuristic process view of markets initiated by the School of Subjectivism in economic science.

To promote competition and innovation within Latin America's weak institutional setting, a strong policy of deregulation, and limitation to government intervention through political accountability and judicial review is advocated in place of conventional antitrust policy, which would retain a marginal role.

TABLE OF CONTENTS.

LIST OF TABLES.

COMPETITION POLICY AND INSTITUTIONAL REFORM IN LATIN AMERICA

EXPLORING THE INSTITUTIONAL FOUNDATIONS FOR ECONOMIC GROWTH IN DEVELOPING COUNTRIES.

CHAPTER I. COMPETING APPROACHES TO REGULATION AND ECONOMIC REFORM IN LATIN AMERICA.

> *"Creativity often, and perhaps usually, consists of looking at familiar things or ideas in a new way."*
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> (George Stigler, Memoirs of an Unregulated Economist, p. 79.)

In his extraordinary work on the evolution of the Western legal system, Harold Berman explains the role of legal studies in the context of institutional change. He states the following: "It is a task of a contemporary social theory of law to study the fate of law in periods of revolutionary change, not so much in order to examine the rapid substitution of new laws for old but rather in order to examine the ways in which foundations are or are not laid for a stable and just legal order in the future, after the revolution has settled down."[1]

Institutional revolution is underway today in Latin America, and this raises the need for determining whether the foundations are being laid for a just and stable legal order. Since economic reform began in the mid-1980s, the legal systems, of Latin American countries have come under increasing pressure to adapt to change. In the realm of public law, the notion of "Public Interest", which used to underlie legislation enacted in previous decades to foster development goals, has started to be questioned in Latin American countries. Individual rights are acquiring an unprecedented significance in the context of

1 H. Berman, Law and Revolution: The Formation of the Western Legal Tradition, (London: Harvard University Press, 1983), p. 45

legal discussion. Courts are improving and extending the mechanisms of legal review on decisions taken by governments which affect private entitlements.[2]

This is no coincidence; today, much of the weight of government interventionism in the design of "development policies"[3] has lost its appeal as the preferred tool for the economic and social development of the region. The failure of centralised government planning eventually persuaded Latin government officials of the hitherto unseen virtues of market-oriented policies in ensuring efficient social resource allocation, thus creating the right conditions for sustained economic growth.

However, acknowledging market superiority over government planning has not made policy choices easier. Much of the initial awareness that emerged immediately after economic reform began in the mid-1980s was eclipsed after the consolidation of the first stage of reform. Today, the region has begun a second wave or "generation" of reforms, aimed at consolidating the first generation through the restructuring of government and markets, and the creation of proper conditions for sustained growth in the region.[4]

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2 See A. Brewer, Judicial Review in Comparative Law, (Cambridge: Cambridge University Press, 1989)

3 In this work, "development policies" are the set of government strategies attempted in Latin America since the end of the Second World War, aimed at developing an industrial basis for self-sufficiency in the region through regulatory controls, promotional instruments and trade restrictions to spur industrial development. (C. Frischtak, B. Hadjimichael and U. Zachau, Competition Policies for Industrializing Countries, Policy and Research Series, No. 7, Industry and Energy Department [Washington, DC: The World Bank, 1989], p. 2.)

4 For more than a decade now, the region has undergone economic and trade reform, commonly known as *apertura* ("opening"). The new development strategy, implemented since the mid-1980s, was justified by the need to foster modern economies in the region, thereby inducing Latin American governments to adopt, some more reluctantly than others, pro-market measures that were unthinkable in the past: inflation control, trade and foreign exchange liberalisation, lifting of regulatory measures and price controls and elimination of restrictions on foreign investments, to name a few. Today, the first generation of macroeconomic restructuring, consisting of trade reform, correcting fiscal imbalances, privatising state assets, and implementing sound monetary policy has been achieved in many Latin countries. Gomez explains the implications of this policy turnaround: "Latin America's economic and commercial reform, commonly known as *apertura*, has been applied by countries throughout the region but in varying degrees of depth, with Chile performing the two roles of pioneer and champion. (...) The most striking effect of deploying the *apertura* strategy lies in commercial and exchange policy. Import duties were cut dramatically, from an average of 50 percent *ad valorem* to 15 percent in only five years. Most notably, these cuts were applied unilaterally, with no demands for reciprocity, wiping out at the same time a wide range of non-tariff barriers. Exchange controls long in use were scrapped or pared to curb capital outflows." (H. Gómez, "The

However, no matter how much scholars proclaim the importance of these reforms, the fact remains that they are little understood. *The Economist* has described the current state of policy-making in the following terms: "the debate [on the convenience of markets] has moved on [but] motion does not necessarily bring clarity... Views still differ markedly about *how, and how much*, the state should interfere in the functioning of economies." (Author's italics)5

In short, today there is as much confusion as ever about the role of governments in social affairs. Much of the discussion about policy-making for transition economies is still dominated by an ideological bias that emphasises quantitative over qualitative government involvement. Policy-makers still concentrate their debates on how much the state should intervene in the economy (i.e., *how many* state-owned firms should be privatised, *how many* sectors should be regulated, *how many* sectors should be freed from state interference), rather than on the regulatory instruments that could be implemented to improve the overall performance of the economy. Not surprisingly, markets and government intervention are still seen as polarised alternatives which policy-makers are expected to choose between for regulating market transactions and achieving social goals.

Much of the liability for this lack of understanding comes from the formalistic approach which dominates the analysis of those regulatory reforms necessary to implement structural changes in the region. Such analysis shows a poor understanding of those sources of economic development which form a sensible guide for the design of regulation. This work attempts to explain how the ultimate reason for this appraisal rests on the misplaced emphasis of conventional economic theory on the analysis of efficient resource allocation in market interaction, with a corresponding analytical neglect of the institutional reasons behind the discovery of new knowledge, innovation and economic

Globalization of Business in Latin America", 39 The International Executive [1997], p. 228.) A summary of the measures comprising the "second generation of reforms" is found in M. Naim, Latin America's Journey to the Market: From Macroeconomic Shocks to Institutional Therapy, Occasional Papers, No. 62, (San Francisco: International Center for Economic Growth, 1995), pp. 1-7.

5 "Economic Freedom: of Liberty, and prosperity", The Economist, 13 January 1996, p. 21.

growth in social settings. Not surprisingly, the formalism of regulatory design has become a source of frustration for policy-makers since the "first generation" of reforms has reached completion.

Perhaps these limitations are most obvious in the analysis of the type of optimal regulation that could improve market functioning and enhance innovation, entrepreneurship, and economic growth. Great uncertainty dominates the discussion of the basis for those institutional measures which Latin American governments should implement as a second generation of reforms to raise the productivity of *each Latin American*, and more generally to encourage each production unit to become more productive, innovative and entrepreneurial. Policy-makers are gradually arriving at the conclusion that low productivity is more closely associated with poor organisation in the production process which adversely affects the performance of entrepreneurs, rather than the correction of exchange and trade disequilibrium. This brings to the fore a discussion on the capacity of current legal structures to organise human capital and exploit its potential, to develop entrepreneurship and improve the legislation needed to attain these goals.

In this regard, the experience gained since the introduction of antitrust policy in many Latin American countries is particularly illustrative. This policy is currently viewed as a component of the new institutional framework that should be implemented in order to make markets more competitive. The purpose of this work is to explain how public policy can promote competition and entrepreneurship within the context of economic reform in Latin America, and to examine whether antitrust policies contribute to this task. In other words, this work attempts to define a competition policy which is compatible with markets, technological innovation and entrepreneurial creativity.

How did policy-makers come to assume that antitrust policy could promote competition in Latin America? To answer this question we must look at the historical and intellectual setting in which this policy has emerged in Latin America.

1.- THE EFFECTS OF INSTITUTIONAL REFORM ON THE ECONOMIC LANDSCAPE OF LATIN AMERICA.

By the end of the Second World War, most Latin American countries were essentially exporters of primary goods in the mining and agricultural sectors. This made their domestic economies particularly vulnerable to price fluctuations on the international commodity markets.

This situation was taken up by the political elite, who endorsed *dirigiste* economic programmes in the hope of overcoming what they regarded as "dependency" on international markets. To do so, they attempted to build self-sufficient industries capable of meeting growing consumption in Latin American economies. Development policies were used to create capacity in specific sectors and to promote the growth of infant firms. As Frischtak et al. argue, these policies were perceived by policy-makers as necessary to help an incipient entrepreneurial class, facing relatively thin markets with scarce capital resources. "Capacity licensing was used to regulate entry and balance supply and demand. Investment incentives and trade barriers raised profitability and attracted resources to the industrial sector. Procurement policies made use of public sector demand to support local producers. Cost-plus pricing policies accommodated inefficient firms. Restrictive labour legislation, complex bankrupt procedures and financial bailouts discouraged exit in an attempt to conserve capital and protect workers from unemployment".[6]

Accordingly, policy-makers afforded extensive protection to local industries through import substitution policies; in essence, these policies erected tariff barriers and other obstacles to international competition.[7] Table No 1 shows the level of trade protection in the region in the mid-1980s.

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6 C. Frischtak, et al. Op. Cit., p. 2.

7 W. Baer, "Changing Paradigms: Changing interpretations of the public sector in Latin America's economies" 88 Public Choice [1996]: 365-379. Borner et al. highlight the importance of these policies in the region: "Under the intellectual leadership of the U.N. Economic Commission for Latin America, the protective barriers against imports grew and with them grew import-substituting industries". S. Borner, A. Brunetti and B. Weder, Institutional Obstacles to

Table No 1
TRADE INDICATORS MID-1980s
Source: Dean, Desai and Riedel (1994)

Country	*High tariffs*	*Stringent quantitative restrictions*	*Export restrictions*	*Foreign Exchange restrictions*	*Multiple Exchange restrictions*
Argentina	*	*	*	*	*
Brazil	*	*	*	*	
Chile	*				
Colombia	*	*	*	*	
Costa Rica	*	*	*	*	
Mexico	*	*	*	*	*
Peru	*	*	*	*	*
Venezuela	*	*	*	*	*

Along with import substitution, domestic trade regulation was also regarded as an essential step towards internal development; in essence, the implementation of development policies meant that social demands could be met through trade regulation at the expense of competition.8 This process occurred in several ways.

Firstly, extensive nationalisation programmes for development purposes inevitably entailed the creation of legal monopolies and ownership exclusions in many "strategic" industries on the basis of political considerations. As Coate et al. put it: "In numerous

Latin American Growth, International Center for Economic Growth (San Francisco, 1992), p. 7. Latin American policy-makers predicted that import substitution would enable the domestic industrial sector to expand and to reduce its costs through economies of scale and "learning by doing". Export pessimism, in terms of market access and unfavourable terms of trade, also played some role in persuading them to pursue an import-substitution strategy. See M. Kelly and A. K. McGuirk, Trade Policies of Developing Countries, in 'Issues and Developments in International Trade Policy', World Economic and Financial Surveys, Appendix II, (Washington, DC: International Monetary Fund, 1992), pp. 40-41. See also M. Agosin and D. Tussie, "Globalization, Regionalization and New Dilemmas in Trade Policy for Development", 15 World Competition [1992]: 37-63.

8 Local elites quickly understood the political clout they gained, by granting monopolies and economic privileges through these policies, over different social groups. Coate et al. argue in this regard: "Generally price controls are introduced to protect selected groups in the economy. For example, in Mexico and numerous other Latin countries, the urban poor are often protected by controls on food and other necessities, while some countries protect the rich by limiting the price of gasoline. In other cases, selected industries are protected by price controls on raw materials and even financial capital". M. Coate, R. Bustamante and A. Rodriguez, Antitrust in Latin America: Regulating Government and Business (Washington, DC: Federal Trade Commission, Bureau of Economics, 1993), p. 3.

Latin American economies, nationalisation has long been a standard response of the government to perceived economic problems. Initially reserved for natural resource industries such as oil (Mexico, Venezuela) and mining (Brazil, Chile), government ownership expanded to airlines (Mexico, Argentina, Bolivia), banking and insurance operations (Mexico, El Salvador), the telephone industry (Argentina) and even luxury hotels (El Salvador)".[9] Secondly, many sectors left out of nationalisation were nevertheless subject to severe regulation that curtailed any chance for the spontaneous growth of competition. Industrial policies discouraged competition among private producers by means of price controls, and barriers to entry and exit from the market. Price controls generally sheltered the most inefficient producers, thus restricting price competition in the regulated industry. Thirdly, foreign investment regulations forced the local subsidiaries of multinational enterprises to comply with many specific performance requirements; these legal barriers limited the capacity of these firms, particularly the more aggressive or more resourceful ones. Finally, exit barriers (i.e. bankruptcy procedures) were aimed at protecting certain groups which were regarded as especially vulnerable (for example, labour) and ensuring their permanence in the market, notwithstanding their complete lack of competitiveness.

The effects of these measures on Latin American firms and markets were two-fold: Firstly, local markets and industries tended to become more concentrated. Economic concentration in the region reached significant levels in the years immediately prior to *apertura*. Table No. 2 shows these levels in selected Latin American countries.

9 Coate at al., at 3.

Table No. 2
CONCENTRATION OF PRODUCTION IN LATIN AMERICA BEFORE APERTURA.
Source: Economic Commission for Latin America and the Caribbean, Statistical Yearbook for Latin America and the Caribbean, 1996.

Country	*Year*	*Concentration rate by size of establishment. (100 or more employees)*
ARGENTINA	1984	43.7%
BRAZIL	1985	58.2%
COLOMBIA	1970	61%
COSTA RICA	1975	51.6%
MEXICO	1988	64.8%
URUGUAY	1987	39.4%

Secondly, development policies imposed severe restrictions on the capacity of Latin firms to compete, innovate and create economic growth. Frischtak et al. give a good summary of these effects: "In some countries, as the industrial sector matured, governments removed protective barriers and increased domestic firms' exposure to competitive forces. But in most countries, barriers to entry and exit solidified. Capacity licensing and other regulations concerning the establishment and expansion of firms (...) effectively deterred the growth of capacity and the entry of new firms. Investment incentives and procurement policies (...) prevented entry by skewing the rules in favour of dominant producers. Price controls (...) pre-empted competition and helped less efficient firms survive. (...) The infant market rationale [allowing for tariff and non-tariff protection] was turned upside down; relief from import-competition continued to be provided for mature and declining sub-sectors while new activities were penalised".10 It became clear that protective measures had a negative impact on the entrepreneurship, competitiveness and inventiveness of most Latin firms.

Naturally, Latin firms tended to develop their business strategies based on the false expectations created by government protectionism, which in the long-run proved disastrous. Only firms of considerable size could match the costs imposed by the web of regulations; hence the poor records for small and medium enterprises. Firms also had incentives to specialise in sectors whose profitability depended on barriers to foreign competitors. The situation changed dramatically for local businesses when market barriers

10 Frischtak et al., at 2.

were removed as a result of *apertura,* which entailed opening local markets to international competition. As Gómez explains. "By the end of the 1970s, Latin America's highly protected manufacturing firms had more than saturated the import substitution market for their original products and diversified into different industries. Some favoured vertical integration, such as moving backwards from the retail sale of building materials to the production of cement, ceramic tiles, and sanitary fixtures, followed by manufacturing the sacks, cartons, and tape required for packing. Other firms combined the production of chemicals, for example, with packaging materials and food products. For the most part, however, manufacturing plants were small in scale and dependent on imports of machinery and even processed inputs. Once local-tariff and non-tariff barriers were removed in the late 1980s and early 1990s, the undersized plants proved uneconomic to operate in competition with world suppliers. Erstwhile conglomerates shed product after product and focused on their basic line. The stronger Latin American firms, together with multinational firms from outside the region, scrambled across borders to acquire discarded plants suited to their business and buy into local brands".[11]

Apertura brought decisive changes in the corporate landscape of the region, shattering many local firms unable to compete on the new playing field. The sweeping process of corporate change in the region since *apertura* has led, in many cases, to relatively more efficient firms; it has also prompted the restructuring of many domestic firms through take-overs and acquisitions by foreign firms attempting to gain a foothold in these emerging markets.

However, despite increased competitiveness in the business environment, a new kind of resistance is growing among policy-makers in the region. Indeed, everyone has not welcomed these changes. Obviously, the arrival of newcomers is unpleasant for established firms enjoying entrenched privileges, as it threatens to drive them out of the market. However, aside from these practical implications, *apertura* is perhaps more endangered by the conventional perception of social phenomena shared by intellectuals, scholars and policy-makers, who may still be committed to their old ways of viewing policy-making. This perception is far from being overcome, and is responsible for leading

11 Gómez, p. 228.

them to frequently endorse policy initiatives which run against the logic of markets. It is here that "competition policies" implemented in the region offer an interesting case study, on how ideas and perceptions governing policy-making may have endured despite the best efforts to open up markets and liberalise the economy.

2.- INTRODUCTION OF COMPETITION POLICY INTO THE INSTITUTIONAL REFORM OF LATIN AMERICA: FROM SYMPATHY TO CONFUSION?

Many policy-makers view competition policy as a tool for ensuring the success of *apertura* and economic reform in Latin America. Increased industrial concentration therefore accrued in the region before *apertura* cultivated the perception that a government policy targeted to the promotion of competition was necessary. Consequently, "during the 1980s virtually every developed nation strengthened its competition laws while some countries enacted new laws designed to ensure that barriers to trade and competition, once removed by the state, would not be resurrected by private action".[12]

In general, it has been suggested that antitrust policy is needed to ensure the dismantling of trade barriers which would otherwise be restored by business manipulation. There is a growing conviction that antitrust policy is needed to prevent anti-competitive business practices as firms struggle to preserve their prerogatives, granted under previous industrial policies through tariffs and non-tariff barriers.[13]

12 R. Boner and R. Krueger, The Basics of Antitrust Policy: A Review of Ten Nations and the European Communities; World Bank Technical Paper Number 160; (Washington, DC: The World Bank, 1991.) at ix.

13 The concern that government barriers may be substituted by private ones has been a common thread throughout all discussions concerning the liberalisation of domestic markets and their integration in regional (or international) ones. The Commission of the European Communities stated in a note submitted to the OECD: "The transition from a series of national markets, with business activity organised predominantly on national lines, to an open and competitive situation within a single market, requires that particular attention be paid to practices which would have the effect of perpetuating the existence of national boundaries to economic activity and the lost economic opportunities resulting from such fragmentation of markets". (Commission of the European Communities, The Objectives of Competition Policy, Note submitted to the Meeting of the Committee in Competition Law and Policy -OECD, 20-22 May 1992, Paris, DAFFE/CLP (92) 1/EEC-Restricted Document). The proclaimed antitrust goals in regional jurisdictions such as the European Union or the Andean Pact provide a good example of the need for this policy to counteract the fear that new private barriers to trade will substitute official ones. On the Andean

Antitrust enforcement is also sought to prevent privatised firms from being acquired by potential or actual competitors, thus reinforcing a dominant position in the local market. De-socialising without de-monopolising confers little benefit on the reform process.14 Thus, "there is an important role for competition policy in the privatization process –to ensure that state monopolies are not simply transformed into private ones".15 Others regard antitrust as necessary for the prevention of pre-eminent or dominant positions in the local market arising from foreign investments made by multinational enterprises.16 Finally, antitrust has been regarded as important for the development of a new business culture; for this reason, antitrust authorities have insisted upon the pedagogic use of antitrust statutes as tools to combat economic guilds, set up by chambers of commerce, business associations and trade unions, which had been openly encouraged by former government policy.17

Pact experience, see Junta del Acuerdo de Cartagena, Elementos de Juicio para la revisión de la Decisión 230, JUN/dt 289 - (Lima, 1990), p. 6. For a comparative appraisal, see P. Muchlinski, Multinational Enterprises and the Law, (Oxford: Blackwell, 1995.) On the interface between trade and competition policies see F. M. Scherer, Competition Policies for an Integrated World Economy, (Washington, DC: The Brookings Institution, 1994).

14 Following this view, competition is generally enhanced if existing state-owned enterprises are split into smaller, viable firms before privatisation. Unrelated unprofitable activities can be jettisoned, and monopolies can be split into separate competing firms. The activity of antitrust agencies in the privatisation process is to restructure existing public enterprises, facilitating the entry or establishment of new firms. See, UNCTAD Secretariat, La función de la política de defensa de la competencia en las reformas económicas de los países en desarrollo y otros países; Estudios relativos a las Disposiciones del Conjunto y Consultas sobre Prácticas Comerciales Restrictivas, TD/B/RBP/96/Rev.1. Geneva, 10 Aug. 1994, pp. 36-41.

15 Conclusions, Seminar on Competition Policy and Economic Reform, OECD, World Bank, CADE, IBRAC, and the Fundação Getúlio Vargas, Rio de Janeiro, 10-13 July 1997. Many Latin American antitrust agencies have extended their surveillance over the privatisation process. The Colombian *Superintendencia de Industria y Comercio* can provide advice on the privatisation process; similar provisions exist in the Mexican scheme. In Venezuela, *Superintendencia Pro-Competencia* has developed a scheme whereby the agency advises other public entities involved in privatisation. The emphasis placed on this particular activity by antitrust scholars in reference to competition in developing countries is significant. See for example, R. Khemany. The Role and Importance of Competition Advocacy in Promoting Competition, paper presented at the "Emerging Market Economy Forum: Workshop on Competition Policy and Enforcement", Buenos Aires, Oct. 28-30, 1996.

16 UNCTAD Secretariat, La función de la política de defensa de la competencia ..., pp. 42-48.

17 Id., pp. 14-15. In this regard, Willig contends: "Competition, and the consumer benefit it brings, require a code of business conduct to assure that apparently rival offers are truly independent". (Willig, Anti-Monopoly Policies and Institutions (n/p) (n/d), p. 3.) Otherwise, it is natural to expect that no competition will spontaneously develop because, as Ordover and Pitman ask: "How much more of a tendency to collude will exist among newly-formed firms in economies

To sum up, antitrust policy may be necessary to overcome potential delays in the implementation of institutional reforms. The delays experienced in the introduction of a reformed institutional framework could prevent competition from flourishing spontaneously. Antitrust would then be needed to fill the regulatory gaps left by unconstrained deregulation. For example, Boner and Langenfeld claim that the liberalisation of trade which would otherwise foster competition, is slow and cumbersome: "Certainly, liberal trade does not conflict with antitrust; yet, liberal trade, though often touted, is seldom fully applied (...) Thus, though liberal trade can enlarge the commercial options available to buyers and sellers, this does not always occur in practice. In regional or local markets, liberal trade policies do little to enhance competition".[18]

These authors hold that a "shock therapy" approach, brought about by a liberal policy, could in fact have the opposite effects by creating stiff domestic opposition. In this context, antitrust could play a political role in the transition by attacking cases of price fixing, monopolisation of markets, and so on, without the hardships of "closed factories, rampant unemployment and rising economic misery" resulting from sudden liberalisation.[19] This gradual approach may provide a more stable means of pursuing reform because it addresses the distortions before subjecting the domestic economy to the massive shocks that accompany fully liberalised trade. Guash and Rajapatirana argue that although trade liberalisation in the 1980s and 1990s has strengthened import competition, these policies alone cannot create a competitive economic environment. Indeed, they believe trade policy as an instrument of competition policy has been constrained by the disproportionate amount of non-traded goods, vertical integration, and distribution

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where competition, far from being encouraged for years, has been illegal?" (Ordover and Pittman, Op. cit.)

18 R. Boner and J. Langenfeld, "Liberal Trade and Antitrust in Developing Countries", CATO Review of Business & Government-Regulation, [Spring 1992]: 5-6.

19 Boner and Langenfeld, p. 2. Following the same logic, see Ordover and Pittman, p. 3

monopolies. In their opinion, this is the reason why competition policies can prevent exclusionary practices, collusion among competitors and the abuse of market power.[20]

From the viewpoint of normative economics, these divergent opinions can be grouped as follows. On one side there are those who think that antitrust policy will promote economic efficiency in the allocation of social resources. On the other side, there are those who believe that there are profound inequalities and economic concentration existing in the region, and who therefore see in antitrust policy an instrument to overcome these inequalities, even if this means the sacrifice of efficient resource allocation in the long run. In practice, achieving equality could be achieved through regional development, the promotion of small business, export promotion, the decentralisation of decision-making, or the integration of regional markets.[21] Finally, there are those who endorse an "eclectic" approach towards Latin American antitrust enforcement which combines efficiency concerns with more interventionist structural initiatives whenever required.[22] These scholars are inclined to believe that by pursuing a more varied and *flexible* policy focused on structural imbalances within the market, efficiency can be achieved in the long run. In this regard, "the laws on competition in the (Latin American region) share the overall objectives of promotion and defence of competition, with the aim of promoting freedom of initiative, economic efficiency, fair and equal participation for small and medium enterprise, dilution of economic power and distribution of economic opportunity, preventing creation of monopolies and improper use of position of domination to the

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20 J. L. Guasch and S. Rajapatirana, The Interface of Trade, Investment and Competition Policies: Issues and Challenges for Latin America, Policy Research Working Paper No. 1393, (Washington, DC: The World Bank, 1994.)

21 See M. Rowat, Competition Policy in Latin America: Legal and Institutional Issues, p. 2; also, L. Tineo, Competition Policy and Law in Latin America: From Distributive to Efficient Market Regulations, Paper presented at the Emerging Market Economy Forum Workshop on Competition Policy and Enforcement, OECD/World Bank/Government of Argentina, Buenos Aires, October 28-30, 1996.

22 See L. White, Antitrust in a Developing Country: The Case of Venezuela, Internal Discussion Paper, Latin America and the Caribbean Region, The World Bank, Washington, DC, August 1990, pp. 4-6. Also, A. Jatar, "Política de Competencia y legislación antimonopólica", 9 Revista de la Fundación Procuraduría General de la República de Venezuela, [1994]: 357-360.

benefit of consumers and users, by means of increased diversity of products at competitive prices".23

Thus, there is a consensus on the need for the implementation of antitrust policy as a healthy initiative for safeguarding the commitment to economic liberalisation. This policy is regarded as the proper device for encouraging an "optimal" resource allocation directed against business manoeuvres which attempt to impose unilateral conditions through the "market power" gained by the recent liberalisation of markets in the region.

The former reasons explain why policy-makers feel the need for a policy which is consciously oriented to the promotion of competition. As Jatar and Tineo contend: "Effective competition is expected to develop by exposing the highly concentrated and protected markets of the region to international competition. Competition [viz., antitrust] policy plays three important roles in this process: Firstly, it enhances market access for new competitors. Secondly, it protects the competition process from business restrictive practices. Thirdly, and most importantly, it fosters economic efficiency and consumer welfare."24

From a legal perspective, antitrust legislation has also been hailed as a device which ensures the proper exercise of individual economic rights. For this reason, it has been closely linked to the protection granted in relation to property rights in almost all constitutions of the region.25 The fact that this legislation did not evolve in the region

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23 OAS, Inventory of Domestic Laws and Regulations relating to Competition Policy in the Western Hemisphere (Preliminary Report): SG/TU/COMPOL/DOC.1/96/Rev.1, Trade Unit (Washington, DC: Organization of American States, October 1996), pp. i-ii. Nevertheless, White seems to suggest that, notwithstanding the several and differing goals, antitrust in Latin America is aimed at enhancing efficiency. (L. White, Antitrust in a Developing Country...)

24 A. Jatar and L. Tineo, Competition Policy in the Andean Countries: The Ups and Downs of a Policy in Search of its Place, Paper presented at the conference "U.S. - Andean Trade and Investment Relations: Policy Issues and Choices" sponsored by the Andean Development Corporation, Organization of American States and Inter-American Dialogue, September 3-4 (Washington, DC: Brookings Institution, 1997), p. 2.

25 Antitrust rules are referred to as a development of constitutional economic rules. See for example, I. De León, "Inflación, Prácticas Monopólicas y Especulación: Las amenazas a los Derechos del Consumidor en una Economía Abierta", in Inflación y Derecho XIX Jornadas J.M. Domínguez Escovar (Barquisimeto: Colegio de Abogados del Estado Lara, 1994) also, A. Brewer, Instituciones Políticas y Constitucionales, (Caracas: Universidad Católica Andrés Bello,

until relatively recently is not regarded as evidence of a lack of consistency between antitrust statutes and such constitutional principles, but is related to the circumstantial fact that the former regulation of prices and competition frustrated all attempts to enforce antitrust laws effectively.

Following these ideas, several countries in the region have adopted modern antitrust schemes in the last decade, as Table No. 3 shows.

Table No. 3
ANTITRUST LAWS IN LATIN AMERICA.
SOURCES: ORGANISATION OF AMERICAN STATES, INVENTORY OF DOMESTIC LAWS AND REGULATIONS RELATING TO COMPETITION POLICY IN THE WESTERN HEMISPHERE (PRELIMINARY REPORT).

COUNTRY	REGULATORY FRAMEWORK
ARGENTINA	• Law on Protection of Competition No. 22,262, July 7, 1980. • Decree No. 2.284 of 1991 on Deregulation of Domestic Trade in Goods and Services.
BRAZIL	• Law for the Prevention and Repression of Infringements Against Economic Order No. 8,884, June 11 1994, amended in 1995. (Grants the Conselho Administrativo de Defesa Econômica [CADE] administrative independence, and sets forth the relevant provisions on the prosecution of offences against "economic order".) • Law No. 9021 of 1995. (Regulates the activities of CADE) • Law No. 7347 of 1995. (Regulates legal liability for civil offences resulting from restrictions on free competition.) • Resolution No 186 of the Ministry of Justice of 1992. (CADE's internal structure.)
CHILE	• Decree No 511 of 1980, amending Decree-Law No. 211 of 1973 (Law on Protection of Competition.)
COLOMBIA	• Law on Restrictive Business Practices No. 155, December 24, 1959. • Decree No. 2153 of 1992 restructuring the Superintendence of Industry and Commerce. • Decision 285 of the Andean Commission on the rules to prevent or correct distortions of competition caused by Business Practices restricting Free Competition.
COSTA RICA	• Law for the Promotion of Competition and Effective Protection of Consumers. No. 7472, December 1994. • Decree No. 24234-MEIC of 1996 (Regulations of the Law)
MEXICO	Federal Law on Economic Competition, December 24, 1992.
PANAMA	• Law No. 29,1996 on Protection of Competition and Other Measures.
PERU	• Law to Eliminate Monopolistic Practices that Control and Restrict Free Competition, Decree-Law No. 701, November 7, 1991. • Decree Law 788 amending Decree Law 701. • Decree Law 807 amending Decree Law 701.

1982), pp. 495-499. Also, Informe Anual 1993-1994, Comisión Federal de la Competencia, Mexico, pp. 54-55. In the landmark decisions *Northern Pacific Railways v. United States*, 356 U.S. I, 6, 8-9, 10 N.8 (1958) or *U.S. v. Topco Associates Inc.* 405 U.S. 596,610 (1972), the U.S. Supreme Court regarded the Sherman Act of 1890, which epitomizes antitrust policy in the United States, as the "Magna Carta of Economic Rights".

	• Decision 285 of the Andean Commission on the rules to prevent or correct distortions of competition caused by Business Practices restricting Free Competition.
VENEZUELA	• Law for the Promotion and Protection of Free Competition, December 1991. • Regulation No 1 of 1993 on the Exemptions regime. • Regulation No 2 of 1996 on Economic Concentrations. • Resolution No 036-95 on Global Exemptions from Exclusive Distribution and Supply. • Decision 285 of the Andean Commission on the rules to prevent or correct distortions in competition caused by Business Practices restricting Free Competition.

However, apart from making formal statements, it is necessary to carry policy analysis beyond conventional assumptions and examine in descriptive terms whether antitrust policy does, in fact, promote competition, or whether there are alternative means of achieving this objective. Our hypothesis is that antitrust policy is a self-defeating policy that belongs to the same breed of interventionist policies which were implemented with disastrous consequences in the past. Even if the need for competition policy is undeniable, it should be construed along different lines to conventional antitrust policies.

To explain why antitrust policy has been adopted in Latin America as a tool to promote competition, it is important to explore the intellectual soil in which such policies found conditions favourable enough to flourish. It is therefore necessary to abandon superficial explanations, which only look at the stated purpose of law-making, and focus on the institutional incentives which lead policy-makers to shape policies in a given fashion. Only in this way is it possible to foresee the likely consequences arising from enforcement of these initiatives.

This provides the clue for understanding the essence of many regulations issued after *apertura*. Some of these, like antitrust regulation, may run counter to the logic of market functioning, but are nevertheless adopted on the assumption that they will correct perceived market failures and are therefore needed. Policy-makers have adopted antitrust policy in Latin America at face value, assuming that it will promote business competition, while ignoring its effects on the behaviour of firms and markets. In particular, they have ignored that *its rationale runs counter to market logic*, and that it could therefore hamper rather than reinforce their functioning. They have also overlooked the fact that this is a policy which requires considerable levels of accountability, which the weak institutional settings of Latin America are unable to provide.

This work analyses whether antitrust enforcement promotes business competition. The perception that this is indeed the case can be traced back to conventional ideas about "public interest" regulation, social welfare and well-intentioned government intervention.26. This appraisal has biased the perception of both unfettered market functioning and government intervention: while the former is regarded suspiciously, the latter is viewed as a "corrective" device against the misallocation of social resources resulting from market malfunction. In the minds of Latin American technocrats and economists, most of them educated in the conventional tradition of "public interest" regulation, the achievements of trade liberalisation are insufficient to ensure competition. It seems as if deregulation and trade liberalisation, rather than promoting the cause of markets, could undermine them by favouring a few *dominant* firms to take *control* of Latin American markets in the instance of government retreat from market surveillance.27 Market concentration does not appear as the natural process of adaptation to new opportunities, in which more efficient firms gain increasing market shares and displace

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26 "Public interest theories of why regulation emerges are based on normative rationales for optimal intervention. In these theories regulators are assumed to maximise social welfare. Empirical analysis of regulatory effects become a test of whether or not regulatory institutions are successful in achieving their welfare-maximising objectives and a basis for quantifying the costs and benefits of regulations." (P. Joskow and Nancy Rose, The effects of Economic Regulation, Handbook of Industrial Organization, Vol. II., R. Scmanlensee and R.D. Willig (eds.) Elsevier Science Pub., Boston, 1989, p. 1452.)

27 Following this opinion, Frischtak et al. have argued that antitrust policy complements the failures of reforms in removing trade barriers: "When natural and strategic barriers to competition are significant, the removal of policy generated barriers might not be enough to stimulate an efficient supply response. Policy-makers need to provide a structure of incentives and an institutional setting to stimulate entry and competition in industries where dominant incumbents need to be challenged to improve their performance. These policies should help entrants overcome large natural barriers -such as limited access to fixed facilities, and lack of technical and marketing information. Mergers should be discouraged if there is a significant probability that the new company would have the market power to deter entry, engage in unfair trade practices and keep prices above competitive levels. The legal and regulatory framework should define the limit of acceptable market conduct and curb anti-competitive behaviour". (Frischtak et al., p. 3.) Ordover and Pittman also argue: "it is simply not the case that open borders or large numbers of competitors or easy entry or ensconced competitive values have prevented the formation of cartels". (Ordover and Pittman, p. 2.)

inefficient smaller competitors. Rather, they seem to be manipulating the situation in order *to reap the benefits of deregulation*.

In this work we will examine how these ideas emerge from the analysis of conventional industrial organisation theories on Latin America's industrial structure, under which the latter always appears as highly concentrated.[28] Not surprisingly, the reduction of industrial concentration through regulatory policies such as antitrust has quickly become a top priority of regulatory agencies throughout the region. In this light, Jatar concludes: "The transition from protectionism to international competitiveness requires a profound structural adjustment to encourage competition and efficiency. In doing so, the development of common rules to organise business transactions and trade among countries is a major challenge. Antitrust policy is a key instrument in this effort".[29] It is not surprising that antitrust policy has been perceived as a natural ally in the process of opening up markets.

Theories are useful tools which enable social scientists to make sense of reality. However, the limitations of their founding assumptions are seldom realised by policy-makers, who are often inclined to derive policy implications from them without much thought. Loasby warns about the risks of such over-confidence: "If the basic principles of [these] philosophical systems are treated, not as inventions of the imagination but as true axioms, then the pursuit of abstract rigour may easily be mistaken for an increase of understanding."[30] Such unawareness has led scholars to endorse antitrust policy without

28 Industrial concentration is a feature often emphasised by antitrust scholars in Latin America, as clearly evidenced in Jatar's words: "after following for decades inward looking strategies, [Latin American countries] show highly concentrated markets. This characteristic has important implications for antitrust enforcement. First, the probability of cartelized behaviour is particularly high under these circumstances, thus surveillance and prosecution of horizontal agreements among competitors represent a high priority for competition agencies. Similarly, dominant firms may exert market control after prices are liberalised by government. This is particularly the case in non-tradables, and in sectors where potential foreign competition is hampered by high barriers to entry in distribution" A. Jatar, Competition Policy in Latin America: The Promotion of a Social Change, paper presented at the meetings of the American Economic Association, January 1995, pp. 5-6.

29 A. Jatar, Competition Policy in the European Economic Community: Lessons for Latin America (forthcoming)

30 B. Loasby, Equilibrium and Evolution: An exploration of connecting principles in economics,

examining first whether such regulation is compatible with the promotion of competition, as expressed in the intensity of market exchanges, business innovation, increasing returns and the discovery of new information, which are the most obvious signs of such phenomena. The lack of a fully developed economic theory explaining these phenomena accounts for much of the current misunderstanding in this field.

Indeed, there is no settled meaning for the term "competition". This concept has changed over time, making it difficult, if not impossible, to define its essence and therefore that of the policy designed to protect it. In the legal tradition of Common Law, competition was regarded as the antithesis of legal privileges, monopolies and royal prerogatives. However, the introduction of antitrust schemes at the turn of the century *changed that concept of competition*. Since then, the term has become linked to some vague standard of market performance, which neo-classical economic models attempted to represent without much success, as we shall see.

Therefore semantics matter; and it is important to dig beneath the surface of the statutory "public interest" objectives proclaimed by so-called "competition" laws, in order to seize their essence, which in turn enables a proper appraisal on whether it is consistent with the goals sought by *apertura*.

This work challenges the view that antitrust policy is a new form of regulation that is qualitatively different from the interventionist policies applied in the past in the region. It contends that in fact antitrust represents the reinstatement –albeit a disguised one– of a new breed of interventionism, which will stifle not spur competition, innovation and economic growth in the region. This is not an unfounded claim, considering that throughout its history, Latin America's policy-making has always in one way or another been pervaded by a strong tradition of centralist, bureaucratic, anti-market bias, which has tended to favour distribution mechanisms across society over wealth creation.[31] It is

(Manchester: Manchester University Press, 1991), p. 24.

31 See in general C. Veliz, The Centralist Tradition of Latin America, (Princeton: Princeton University Press, 1980.)

not unrealistic to expect that those who have private interests affected by the institutional reform brought about by *apertura* will resist any changes to the status quo and avoid competition by reproducing old policies in a new –and paradoxical– fashion. Both prevailing ideas on the conduction of policy-making and the protection of vested interests have worked jointly against market reinforcement, and today they are working against institutional change in Latin America.

3.- THE ROLE OF PARADIGMS FOR UNDERSTANDING PUBLIC POLICY AND REGULATION.

What, then, is the essence of competition? The answer to this seemingly simple question is more complex than appears at first sight. Competition is a social phenomena, and therefore possesses no single objective interpretation, but is linked to our perception and understanding of markets and social reality.

This leads us to consider the importance given in this work to the problem of conflicting points of view in the appraisal of reality. This is an essential factor in understanding the methodology that we shall use to examine the problems of enforcing antitrust policy in Latin America.

In respect to this question, we will avowedly avoid the traditional method of legal science to examine the implications of enforcing antitrust regulations in Latin America. The traditional method of legal science is formalistic, in the sense that it views social rules as simple instruments emerging from those bodies formally acknowledged as law-making entities. This method is based on the literal interpretation of written rules enacted through codification. It has emerged as a by-product of the influence of logical positivism in social sciences since the mid-nineteenth century to this day.[32] The method inadequately casts

32 From this period, social science lost all significant contact with political philosophy and social scientists concentrated on achieving value-neutrality in science. A more precise conception of science emerged, focusing on causal laws and quantitative methods. Separate disciplines of political economy, history, philosophy, and law emerged within more precise technical boundaries. Making positive law the central focus for study required a change in legal method. As a result of this intellectual influence, the methodology of legal science changed dramatically, from an historical, sociological and explanatory approach to a mechanical one, mostly concerned with explaining legal rules in terms of "facts": "Since science was engaged with the [factual] realm of inquiry a science of law would, it was assumed, need to be erected on a

light on the reality of developing countries, where official authorities clearly possess limited legitimacy in their law-making activities, as this is frequently surpassed by social interaction.[33]

In addition, the conventional legal method is unable to explain the complexity of social interaction in creating market rules. Adopting a formalistic approach to the analysis of social reality is not only inconvenient but also improper, since it leaves aside by definition the non-legal substratum of ideas implemented through government mechanisms. Hence, legal institutions may be more fully understood by using a method of analysis which enables the observer to apprehend the richness of those ideas in shaping government, in a way that a formal appraisal cannot reveal. As Baldwin contends, arguing the 'legal' nature of government rules is irrelevant for the purposes of exploring their normative force, and their implications within society.[34] It is necessary to transcend the limitations imposed by the positivistic distinction between "fact" and "value", particularly in the realm of law.

Understanding social rules properly requires an alternative interpretative approximation to reality. This is particularly useful in the analysis of public law because it overturns the vacuum of conventional legal analysis, which merely focuses on determining what internal connections the observer can construct between rules belonging to a predefined set of legislation. In this way, an alternative method could provide a clearer understanding of public regulations by exploring more closely their "values", thus linking their legitimacy to their implications within society.

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foundation of fact. This objective became the quest of legal positivism, which was pioneered by Bentham and refined by John Austin". (Loughlin, p. 20.) Consequently, formalism remained, in the sense of law being "a self-contained body of rules which operates by means of a distinctive system of the conceptual thought". (Loughlin, p. 22.) The formal classificatory approach to public law that emerged had achieved a pre-eminent status by the turn of the century and has remained the dominant method ever since. As Loughlin states: "although Austinian positivism is no longer the primary theory, Austin's method remains dominant." (Loughlin, p. 22.) It is this paradigmatic way of understanding social rules that the conventional legal method favoured and which provided the setting for the emergence of antitrust regulations.

33 On this question, see Chapter IV, below.

34 R. Baldwin, Rules and Government, (Oxford: Clarendon Press, 1995), p. 7.

In our alternative appraisal, the knowledge required to design welfare-enhancing government rules does not arise from empirical observation organised into certain "patterns" or "laws" which are formally bound according to certain basic "rules of recognition".35 Instead, it is given shape and acquires meaning through the development of conceptual structures or interpretative frameworks.36 Therefore, this alternative method of social rules analysis explores the realities of government and the functions which the law is expected to perform in relation to the political system, using historical and sociological perspective.37

The analysis of regulation, around which the discussion of competition policy revolves, cannot avoid linking the analysis of reality to certain guiding values. This is inevitable, if the aim of the scientific quest is to explore the logical basis for the interpretation of social facts. As Demsetz contended, it is ideas that provide the tools for the interpretation of facts rather than facts that shape ideas. This is clearly so in economics, and particularly in discussions on competition.38 In other words, beliefs are not mere subjective states, but they are constitutive of our actions; therefore, in the

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35 On the role of the rules of recognition in providing legitimacy to legal rules, see R. Cotterell. The Politics of Jurisprudence: a critical introduction to legal philosophy, (London: Butterworths. 1989), pp. 97-100.

36 As Weber observed, reality is infinitely complex; it cannot be conceptualised in a definitive manner. (M. Weber, Economy and Society, G. Roth and C. Wittich (eds.) (New York, 1968), pp. 19-22.) One way in which we might obtain an understanding of society is by constructing ideal types of social action. These ideal types are not constructed by generalising the reality through inference. Instead, they are drawn from deductions made by certain assumptions about conduct. In this manner Weber was able to develop models for understanding certain social phenomena. such as economics or law, without denying the variety of activity encompassed within these practices. On the influence of Weber in social sciences, see L. M. Lachmann, The Legacy of Max Weber, (Berkeley: The Glendessary Press. 1971)

37 M. Loughlin, Public Law and Political Theory, (Oxford: Clarendon Press, 1992), p. 35.

38 H. Demsetz, "Two Systems of Belief about Monopoly" in Industrial Economics O. Williamson (ed.). (London: Edward Elgar, 1996). p. 359. In this field. it is not possible to dissociate fact from value, since, as Berlin stressed, human beings (whose interaction constitutes the subject matter of the social sciences) are self-interpreting creatures: "Men's beliefs in the sphere of conduct are part of their conception of themselves and others as human beings; and this conception in its turn. whether conscious or not, is intrinsic to their picture of the world." (I. Berlin. "Does political theory still exist?" in P. Laslett and W. G. Runciman (eds.). Philosophy. Politics and Society (Second series), (Oxford. 1962). p. 1.)

absence of final "truth" the best that policy-makers can do to regulate social phenomena (such as business competition) is to try to understand them by presenting a range of alternative explanatory frameworks.39 This shows that public law and regulation are nothing but the expression of a particular epistemology applied to social phenomena.40

Moreover, this epistemology combines varied and complex sources, all of them giving shape to governmental processes within which regulation is adopted. Similarly, the multiplicity of these values which provide such governmental processes their legitimacy, can only be fully appraised though a non-legalistic approach.41 For this reason, this work focuses on the impact of the evolution of economic theory thinking (i.e. the theory of the firm and the market) on government regulation and on the understanding of social rules. Indeed, notwithstanding that law-making processes entail a complexity of values, it is necessary to acknowledge the special persuasive force of normative economics in the design of government regulation.42 As Joskow and Rose contend, "regulatory activities (...) share common foundations in welfare economics and political economy and may affect the same economic variables."43 In this respect, this work emphasises how contrasting ways of understanding drawn from economic theory affect our perception on the role of regulation with regard to markets, which is an alternative and rigorous way of

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39 Developing ideal types of business competition to gain a clearer analysis of the most expedient ways to promote it through government rules is ultimately dependent upon our perceptions of reality. These perceptions are dependent on criteria found *outside* the mere examination of facts. As Kuhn stated: "No natural history can be interpreted in the absence of at least some implicit body of intertwined theoretical and methodological belief that permits selection, evaluation, and criticism. If that body of belief is not already implicit in the collection of facts -in which case more than 'mere facts' are at hand- it must be externally supplied, perhaps by a current metaphysic, by another science, or by personal and historical accident." (T. Kuhn, The Structure of Scientific Revolutions, (Chicago: The University of Chicago Press, 1970.), pp. 16-17.)

40 In this sense, Loughlin argues, "there is no neutral language of public law. We can understand what a writer is saying only of we understand the political tradition within which the writer works." (Loughlin, p. 230.)

41 Baldwin, pp. 16-58.

42 See A. Katz, Positivism and the Separation of Law and Economics, 94 Michigan Law Review (1996), pp. 2229-2269.

43 Joskow and Rose, p. 1450.

approaching the dialectic relationship between government intervention and economic rights.

Consequently, this work identifies two alternative paradigms of understanding that explain social phenomena, and subjects them to rational examination in the light of an empirical understanding of the functions of government and the law.[44] The first understanding visualises markets through the conceptual structures and intellectual premises of neoclassical economic theory, which has become conventional in economic analysis. Markets are portrayed as close-ended entities that social analysts can appraise thoroughly due to their assumed omniscience of all the conditions influencing the conduct of market participants. In this paradigm regulations fulfil an instrumental role; that is, they are designed to achieve goals which are deemed socially beneficial, as devised by the ruler, who commands all the interstices and information required for reaching such conclusions. In other words, regulation entails "orders", which are either formulated in narrow terms, or provide flexible space for the enforcement authority to use its discretion to achieve "social goals". The ruler is assumed to possess sufficient information to gain a full understanding of social processes, and to identify welfare-enhancing social goals

44 In social science, paradigms are a particular *way* of rationalising reality. They represent "(...) a conceptual framework within which scientific theories are constructed; they are closed systems of knowledge whose parts are related to each other as well as to the whole structure. They focus attention on the object of research as a system; something that exists 'out there' as an integrated self-contained entity or as a bounded structure." (M. Addleson, "Competition", in The Elgar Companion to Austrian Economics, P. Boettke (Ed.) (Hants: Edward Elgar Publishing Ltd., 1994), p. 98.) According to Kuhn, they give rise to *normal science*, which is imposed by the scientific community "through the standard textbooks and through education". (Loughlin, p. 31.) This notion provides us with a mental construction for visualising the kind of problems that the conventional perspective of regulation presents us with, for which particular solutions are devised. These problems, as well as the proposed solutions, result in a better understanding of dispersed facts. Viewing reality as a set of types or paradigms is useful because it facilitates classification, and enables a better understanding of an otherwise unintelligible reality. Kuhn clearly saw the essential feature of paradigms as presenting "new problems" to be solved, rather than "new solutions" to the problems raised by a given prevailing paradigm. In his words: "One of the things a scientific community acquires with a paradigm is a criterion for choosing problems that, while the paradigm is taken for granted, can be assumed to have solutions. To a great extent these are the only problems that the community will admit as scientific or encourage its members to undertake. Other problems, including many that had previously been standard, are rejected as metaphysical, as the concern of another discipline, or sometimes as just too problematic to be worth the time. *A paradigm can, for that matter, even insulate the community from those socially important problems that are not reducible to the puzzle form, because they cannot be stated in terms of the conceptual and instrumental tools the paradigm supplies.*" (emphasis's is author's) (Kuhn, p. 37.)

which could be achieved through government policy. This particular insight of social phenomena has prevailed overwhelmingly in public policy, thus reaching a status quo.[45]

The second perspective presents a different outlook of regulation. Following new appraisals drawn from economic theory about the open-ended nature of markets and the growth of knowledge, it holds that the nature and purpose of government regulations is to reinforce individuals' interaction in the social setting. Indeed, this appraisal examines the basic problem of sheer uncertainty, faced by entrepreneurs in their productive activities, which constantly drives them to stick to routines in their business activities in order to make their investments' yields more predictable. The impossibility for entrepreneurs to do away with these business routines embodies the very core of their legitimacy, namely, that they fulfil a stabilising role in the expectations that entrepreneurs share with their involvement in market activities. Most importantly, these expectations create the ebb and flow of productive activities, because they stimulate entrepreneurs to innovate and compete in discovering new products and markets. Therefore, the stabilising role of social rules examined under the recent developments of economic theory gives an important alternative measure for judging the legitimacy of government regulation, which conventional economic analysis cannot provide, much less a legalistic appraisal.

In this work we therefore attempt to explain how economic science may provide two opposing views by which government regulation is understood and enforced, as seen in the case of competition policy.

4.- CONTRASTING APPROACHES IN THE STUDY OF COMPETITION POLICY.

These paradigms will enable us to visualise more clearly the complex intellectual process which gives rise to the regulatory policies attempted in Latin America, and of which antitrust policy is merely an example. In particular, it is useful to visualise how

45 Interestingly, Loasby notes that ideas and theories, very much like the conventional visualisation of markets, tend to reach settled equilibria once they have been challenged by opposite views. In this regard our conventional paradigm of regulation simply follows ideas about the firm, the market and the role of institutions which have already become conventional in the realm of economic thought. (see Loasby, Equilibrium and Evolution, pp. 1-26)

competition policy in Latin America is identified with one particular way of appraising reality, and therefore, why the abstract discussion of competition policy goals is futile, and can only favour "a shrill cacophony of divergent opinions".46

Understanding competition policy requires awareness from the observer that the notions of "competition" and "monopoly" remain confined to the premises within which the current paradigm confines the discussion.

For this reason, we propose an examination of the intellectual foundation of the paradigm that supports antitrust regulation and an inquiry into how satisfactorily this characterises competition as the social phenomenon which it purports to regulate. We shall then present an alternative paradigm for conceiving regulation in the light of an alternative understanding of competition. Otherwise, if we limit ourselves to explore competition "within" the boundaries of a particular paradigm this will provide no real answer to the problem of the ability of the policy to promote competition, because it will confine the solution to the contrived definition of competition supported by the paradigm.

It is interesting to note that the concept of competition has not remained unchanged over time. Prior to the introduction of antitrust policy with the U.S. Sherman Act, competition had been regarded as a process of rivalry linked to the undisturbed exercise of individual economic rights. Monopolies were associated with the artificial legal privileges granted by governments to favour the interests of certain individuals over others.47 Legally, it was easy to identify such artificial restrictions, and to combat the privileges they created, which were a part of everyday life. One person's privilege to undertake an economic activity meant another person's exclusion from it. By contrast, the emergence of antitrust policy linked both competition and monopolies to the structure of markets. It made positive economic analysis indispensable in determining the legality of

46 W. Adams and J. W. Brock, Antitrust Economics on Trial: A Dialogue on the New Laissez-Faire, (Princeton: Princeton University Press, 1991), p. xi.

47 On this question, see G. Stigler Memoirs ..., Frank Machovec also highlights how the neoclassical revolution in economic theory displaced the former attention paid to "process", and focused instead on "equilibrium". See generally, F. Machovec, Perfect Competition and the Transformation of Economics, (London: Routledge, 1995)

business behaviour in the marketplace. The significance of legal privileges as deterrents of competition vanished and this was replaced by a willingness to preserve a minimum number of independent actors in the market, as a precondition for assuming the existence of competition. As the ideas on the essence of competition changed, so did the views on the most expedient ways to ensure it, but this change was not always clearly perceived by scholars and policy-makers. As Machlup observed, "competition in the sense of easy entry into the industry, and competition in the sense of many sellers in the industry [is] frequently confused one with the other, or even confounded as one and the same thing."[48] They were all embodied in what this work terms as "the conventional paradigm" of competition, which is exemplified by antitrust regulation.

Increasingly, however, new findings made the growth of knowledge on the nature of markets and firms lead to a whole new understanding of competition and regulation. In this appraisal, regulation initiatives for the promotion of competition are linked to the idea of evolutionary processes that are framed by social institutions such as the market and can be seen to move towards socially productive goals. The conventional view of competition linked to a particular state of affairs in the market is increasingly being replaced by another that emphasises the process of discovering new, unforeseen, valuable market information which enables firms to increase profits, create new products and make new investments.

To choose between these competing insights of competition and regulation one must examine the assumptions underlying such paradigms. In particular, these assumptions and conceptual structures must be subject to rational review in order to determine whether they are consistent and coherent, or contradictory. The interpretative method of public law should cast light on the relationships and features of these structures and the plausibility of their underlying assumptions.[49] In this way, we hope to

48 F. Machlup, "Competition, Pliopoly and Profit", 9 Economica, No. 33, [1942], p. 1. Also, Stigler explains evolution in the sense attributed to market phenomena like monopoly and competition: "Until 1850 in England the word *monopoly* was usually restricted to describing the exclusive rights to trade which were conferred by Parliament. [Then] toward the end of the century (...) *the word changed its meaning*." (See G. Stigler Memoirs of an Unregulated Economist, (New York: Basic Books Inc., Publishers, 1988) pp. 91-92.)

49 Loughlin, p. 36.

reveal why antitrust is a self-defeating policy because it promotes exactly the opposite of its stated purpose.

Many scholars assume too quickly that implementing antitrust policy should set forth higher marks of innovation, entrepreneurial dynamism, and economic growth. However, their conventional *stationary* sense of competition, linked to a particular state of affairs in the market, leads them to endorse policy measures that paradoxically prevent these *dynamic* phenomena to materialise in practice. In this regard, no matter its stated goals, it is quite revealing that antitrust enforcement constantly drives entrepreneurs to revise their business plans and to adapt them to certain predetermined outcomes regarded socially beneficial.

Business strategies regarded in colloquial language as "competitive" are thus condemned on the basis that they either eliminate rivals from the market or impose "abusive" conditions on consumers. By focusing on the past "objective" situation of the relevant market where entrepreneurs interact, antitrust attempts to shed light upon the future "subjective" conduct of entrepreneurs. As a result, antitrust schemes have scored a "verbal coup" by confusing the meaning of competition.50

Such "confusion" highlights the core problem addressed in this work, namely, how regulatory policies are linked to a particular perspective of social phenomena. It is essential to take this into account if one is to understand the likely effects of antitrust policy in Latin American economies. A conventional legal appraisal of antitrust laws cannot give us a proper understanding of the nature of such links because it does not consider the deeper epistemological essence of the problem. An examination of this epistemological question should tell us a great deal about the way in which policies aimed at promoting competition should be designed and enforced.

Ultimately, policy enforcement has to do with the capacity of the conceptual

50 As Sowell indicates, they discuss competition as if these conditions referred to prospective behaviour rather than retrospective numbers. See T. Sowell, Knowledge and Decisions, (New York: Basic Books, 1980), p. 205.

structures to deliver an adequate characterisation of reality. As Kirzner observes: "To judge adequately any aspect of social reality from the ethical perspective calls, of course, for a valid framework of ethical criteria to serve as the evaluative yardstick. But such judgement also requires, perhaps even more importantly, a valid positive understanding of the particular slice of social reality being ethically appraised (...) To judge the morality of a particular economic transaction requires that we fully understand the motives and the likely consequences of that transaction. To judge the justice of a market system requires that we fully understand the workings of that system. Two judges who share the same set of ethical values may judge the morality of the market system quite differently from each other, if one does and the other does not, understand how markets work. These are rather obvious observations, but are often overlooked. It is frequently assumed that in order to defend the market system against its ethical detractors, the defender should disagree with his adversaries more or less profoundly on ethical standards. Of course, such disagreements on standards may be responsible for quarrels about the morality of the market. But very frequently this is not the case. The quarrels over the morality of markets merely reflect different views concerning economic reality".51

After criticising the conventional regulation implemented to promote competition, this work defines the theoretical framework for an "institutional" competition policy. Under this appraisal, several areas are identified where governments can and should emphasise the promotion of competition.

Ultimately, this work attempts, through this analysis, to arrive at a different view of the role of the law in regulating economic behaviour in society, which is a long-standing concern for those who have examined the special role of the law in developing countries.

5.- THE STRUCTURE OF THIS WORK.

Our analysis of contrasting approaches to competition policy is structured as

51 I. Kirzner, Discovery, Capitalism, Distributive Justice, (Oxford: Basil Blackwell, 1989), pp. 3-4.

follows:

Chapter II examines the intellectual traits of the conventional paradigm of regulation underlying antitrust policy in Latin America. The chapter links the intellectual roots of this paradigm to the influence of positivism in legal and economic science, which was especially subject to ideas about society and individual rights, among policy-makers in the region. Following these ideas, Latin American policy-makers often preached the regulation of trade and restrictions of foreign competition in the name of vague "social" or "public interest" reasons. Antitrust policy is thus presented as a new version of such "public interest" regulation, where policy-makers are assumed to possess all the relevant information necessary to achieve these goals and markets are depicted through models of equilibrium, against which reality is contrasted and compared. In the context of these ideas, this chapter describes the main features of Latin American antitrust regulation, its institutional setting and the areas of active enforcement.

Chapter III highlights the theoretical inconsistencies of the conventional approach to regulation on which antitrust precepts are founded. It points out the difficulties of the policy in developing legal rules which distinguish between "anti-competitive" and "efficient" restrictive practices, and its consequent shortcomings in deciding what should or should not be permitted. This chapter illustrates how the internal logic of antitrust policy erodes the expectations of market participants, which constitute the backbone of market functioning. It does so with reference to the Latin American experience, where government intervention is pervasive.

Chapter IV presents a proposal for an alternative institutional appraisal of markets and regulation. It explores how economic organisation provides entrepreneurs with a predictable framework of routines and rules to develop their activities. This approach shows market interaction as an evolutionary process where individuals develop institutions to limit their uncertainty about the future. The chapter challenges the conventional perception of markets, as closed-end entities whose outcomes are accurately predicted by policy-makers as they are assumed to possess the relevant information. Competition in our alternative approach is understood to be an on-going process whereby firms find new information hidden in the system which enables them to gather knowledge about business opportunities. Firms are assumed to adopt routines or patterns of behaviour that enable them to seize business opportunities which would otherwise be unattainable.

Consequently, the role of public policy in this approach is to protect the will of entrepreneurs in undertaking these routines which will induce them to invest a given amount of resources for productive purposes in the expectation of a future outcome. This chapter emphasises how the logic of antitrust policy leads to precisely the opposite of the desired goals. Indeed, because of concern that antitrust achieves some form of predetermined "socially efficient" equilibrium, any business conduct in a market that fails to meet the standards required by this optimum is immediately suspected of being "monopolistic", including the very routines that enable to function.

Next, Chapter IV attempts to define certain guidelines for an alternative institutional policy for the promotion of competition and entrepreneurship in Latin America. It explores the problems that may arise from attempting to reform the official institutional framework. It evaluates the limitations of such an attempt in a democratic setting, given the constitutional principle of "separation of powers". The chapter develops the agenda for promoting competition according to the institutional guidelines outlined in earlier chapters, emphasising that the role of governments in this field is to ensure that the expectations of firms are not frustrated. To do this, it takes into account the institutional difficulties that Latin American policy-makers face in pushing through reform.

Lastly, Chapter V summarises the conclusions of this work.

CHAPTER II.- THE CONVENTIONAL REGULATORY APPRAISAL OF MARKETS AND ECONOMIC ORGANISATION: THE CASE OF ANTITRUST REGULATION IN LATIN AMERICA.

> *"Until the 1920s most economists viewed competition as a ... rivalous process that would be stifled by antitrust laws. Once the perfect competition model -which largely ignores rivalry - was accepted, economists' opinions of antitrust grew more favourable. To the extent that antitrust interferes with rivalry and enterprise, the competitive model has very likely misdirected the profession, at least as far as antitrust policy is concerned."*
>
> (Di Lorenzo and High, Antitrust and Competition, historically considered.)

1.- THE EMERGENCE OF THE CONVENTIONAL PARADIGM OF MARKET REGULATION.

To understand the essence of antitrust rules as tools for regulating markets one has to look at the intellectual sources influencing social science at the turn of the century; in particular, the pervasive influence of logical positivism in legal and economic culture. These influences were echoed in the policy-making tradition, and in Latin American attitudes towards the law, individual rights and the promotion of social welfare. They play a major part in understanding the social role attached to government rules, which explains the necessity of antitrust regulation in ensuring transparent markets in the region.

1.1.- The interface between law and neo-classical economic science in the design of conventional market regulation.

Social scientists have long striven to establish a science of legislation, which could give them guidelines for enacting social rules. By the eighteenth century a science project encompassing social, political, and legal thought had emerged, whose purpose was to make connections between facets of social character such as property, opinions, manners and justice, and to derive general conclusions from these. It was not, however, a science in the modern sense of striving for value neutrality. On the contrary, its objective was to develop guidelines for assessing the laws and institutions of society.

Nevertheless, this multidisciplinary social research disappeared a century later because by then "a much more limited conception of the boundaries of the subject had been erected, and this more restrictive sense of the subject has remained with us until the present day."52 The advance of scientific positivism in the philosophy of science was a primary cause of this development.53 The study of the interface between the social sciences was influenced by the positivist epistemology, which has become dominant within social science in the twentieth century.

The complexity of reality became formalised in "models" which simplified reality. These models explained how market forces would operate in the event of some change introduced by the analyst. Empiricism became essential to demonstrate the truthfulness of these hypotheses. This new perspective used by political scientists aimed at establishing "an empirical discipline based on an inductive methodology, which would permit the testing of hypotheses and thence the identification of regularities which would permit scientifically valid generalizations to be drawn."54 These generalisations could, in turn, embody the core of "social laws", the understanding of which would enable social scientists to improve the welfare of society. To sum up, the analysis of the political constituency's behaviour and that of anonymous firms became the main object of study, whilst the attention given to the structure of social rules and constitutions was abandoned.

Striving to establish a science of legislation was above all an attempt to explain the world rationally; that is, to avoid super-rational explanations. In general, the rising "positive science" of the last quarter of the nineteenth century bore the imprint of a more extensive reaction against the classical thinking embodied in the all-encompassing field of

52 Loughlin, p. 10.

53 The term "positivism" suggests two different meanings. In one sense, it represents an epistemological way of appraising reality, whereas in a second sense, it embodies a philosophy. (M. De la Vega, Evolucionismo versus Positivismo. [Caracas: Monte Avila Editores Latinoamericana, 1993], pp. 50-51.) In this work, we use the term in the first sense, as a method for acquiring knowledge, which is acquired through the senses.

54 Loughlin, p. 26.

Political Philosophy and Morals, which had prevailed hitherto. Thus, theology gave way to social philosophy, theories of divine right were replaced by utilitarian theories of government, and natural law theories were challenged by an emerging positivist outlook. In their efforts to preserve the purity of their newly developed science from the "alien" intrusions of Ethics and Metaphysics, the new generation of social scientists believed that only empirical "facts", as perceived through sensory experience, could provide appropriate explanations for social behaviour. Any appraisal of reality by "aprioristic" methods would be contaminated with preconceived ideas and values about the world, thus rendering them "unscientific". Positivist science pursued "value neutral" explanations of social relations and therefore substituted quantitative measurement for qualitative analysis, a feature which was particularly noticeable in the explanation of market causalities.

The perception of scientific inquiry brought about by logical positivism had uneven effects in both legal and economic science. Compared to legal theorists, economists were more willing to endorse the cultural distinction between facts and values. Such differentiation provided them with a transparent method of inquiry for examining social phenomena. De Alessi contends that "[the positivistic approach] provided a rigorous benchmark for economists' growing interest in empirical research (...) Positivism continues to receive broad acceptance within the economics profession although it no longer reflects current thinking among philosophers of science. Nevertheless (...) it still provides a unifying theme for examining the methodology in economics".55 By contrast, legal scholars have never fully endorsed the distinction between facts and values, even if they have tacitly acknowledged, to some extent, the instrumental appraisal of positivism over legal rules in order to mark their own professional boundaries. As Katz contends, "[P]articipants in our legal culture regard law as more than the commands of an arbitrary sovereign; we expect law to be principled. Positivism is controversial (among legal scholars) because it suggests that we might in some sense be obligated to obey unprincipled laws."56

55 De Alessi, p. 52.

56 See Katz, "Positivism...", p. 2229.

As it was, positivism succeeded in shaping the views of social scientists in the way they perceived their object of research and it therefore became a major force in the making of the "science of legislation". This influence is particularly noticeable in three aspects: first, in the methodological objectivism employed for the appraisal of the real world; second, in the visualisation of real markets through formalistic models of equilibrium, which eliminate institutional analysis by way of postulation, and finally, in its peculiar normative appraisal of reality. All these features combine with the inherent instrumentalism of legal analysis to produce regulations of which antitrust rules are merely an example.

a) The influence of "objectivism" in the analysis of social phenomena.

The conventional paradigm of regulation is defined by the assumption that the analyst is omniscient to appraise the social system. This appraisal is a by-product of the epistemological idea that knowledge can only be seized through the senses. Hence, the observer must detach himself from the feelings and values of those whose behaviour he examines. In this way, "objective" market causalities can be identified.

Bernstein contends that objectivism presupposes "intersubjective standards of rationality or norms of inquiry by which we attempt to distinguish personal bias, superstition, or false beliefs from objective claims."57 In his opinion, objectivism does not require "a simple or direct way of stating the norms of the appropriate inquiry, or that there cannot be disagreement about these norms and their application, or even whether what counts as objective in one domain of inquiry can do so in another".58 Instead, it refers to the impartial perspective that the observer of the social system must possess towards scientific inquiry.

57 R. Bernstein, The Restructuring of Social and Political Theory, (Philadelphia, 1976), p. 111.

58 Bernstein, Id.

In the realm of market relations, whether objective knowledge materialises depends on whether "the actual cost-revenue relationship is an objective something in the sense that it can be scrutinised, in order to discover whether it conforms to the desired relationship, by an *ad hoc* authority external to the industrial unit concerned."[59] Such appraisal allows us to visualise the marketplace as a closed-end static world, comprised of different structural relationships between firms, where both individual and social costs are clearly identifiable and measurable, since what we know about them is simply drawn from our assumptions about the conduct of individual actors.

Objectivism demanded that social scientists follow a value-neutral framework as a means of separating economic "facts" from "values" in policy-making. This was a way of guaranteeing that the framing of social rules by 'Authority' would be subject to rational bounds, by providing stability in the interpretation of social phenomena, and consequently enabling the emergence of a "rational" rule of law to enhance social welfare.[60]

The emergence of objectivism in economic science was mostly evident in the transit from "classical" to "neo-classical" economics, particularly in the latter's formalist version which has prevailed since the second half of this century.[61] This evolution introduced a quantitative view of the causalities affecting social relations which was entirely new in economic analysis. Classical economists had seen markets as changing processes of

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59 G. F. Thirlby, "The Ruler", in L.S.E. Essays on Cost, J. Buchanan and G. Thirlby (eds.), (New York: New York University Press, 1981), p. 165.

60 In fact, objectivity is essential for some antitrust legal scholars, who would consider that the use of neo-classical price theory provides a much-required certainty in the rule of law. As Bork contends: "To read antitrust literature or to participate in the numerous conferences convened to discuss policy is to become convinced that antitrust is less a discipline than a buzzing confusion of unrelated opinion. Even agreement on conclusions is usually superficial, papering over fundamental disagreement about reasons. One cause of this eminently unsatisfactory state of affairs lies in a failure to focus and settle the question of the form of reasoning, or argument, proper to the subject matter. The mode of correct antitrust analysis is determined by the strengths and weaknesses of price theory. Once these are understood and respected, we should achieve greater agreement on substantive issues". (Bork, p. 116). In his work, Bork did not consider the disagreements on economic theory itself, which seem greater and more relevant than those found in the field of law.

61 Machovec explains the emergence of the neo-classical perception in economic science, and why it represented a true revolution of thought (a Kuhnian paradigm) in this field. See F. Machovec, Perfect Competition and the Transformation of Economics, (London: Routledge, 1995).

economic interaction between producers and consumers. These processes were determined by non-quantifiable elements of entrepreneurial action, such as foresight in satisfying consumers and cost-appraisal of available resources. Therefore, the social scientists focused their attention on explaining how these relations were, in qualitative terms. By contrast, positive economics proposed a "rigorous" understanding of social behaviour through abstract formal models of economic behaviour aimed at discovering the regularities of human behaviour. From then on economic analysis left aside its focus on explaining past phenomena, and became concerned with making quantitative predictions of the possible outcomes of the social interaction represented in the models.

Objectivism conveys the assumption that social systems are closed-ended because they encapsulate information that can be fully appraised by the observer for social resource allocation. The possibility of acquiring objective knowledge about the conditions governing social interaction inevitably invites a hierarchical view of the economic system, where the observer placed at the top makes omniscient decisions about the allocation of goods amongst market players. Closed-end systems feature a sort of interaction which combines hierarchically designed commands with multiple interactive elements. An example of this is typically found within firms which combine labour, manpower, technology and other resources into production processes. These structures should be distinguished from social interaction, which is typically open-ended.[62] Let us now see how objectivism has influenced positive and normative views of market functioning.

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62 R. Cordato, Welfare Economics and Externalities in an Open-Ended Universe: A Modern Austrian Perspective, (Boston: Kluwer Academic Publishers, 1992), pp. 5, 111, 116. Cordato borrows his classification from Hayek, who distinguishes between "Economy" and "Catallaxy". He describes "Economy" as a system where a single hierarchy of values dominates social decisions. By contrast, in a "Catallaxy" each participant's values competes with the rest to frame social outcomes; there is no single hierarchy imposed from the top. In this regard, see F. A. Hayek, Law, Legislation and Liberty: Rules and Order, Vol 1. (Chicago: The University of Chicago Press, 1973)

b) Idealisation of market functioning in formal models of equilibrium: The structure-conduct-performance (SCP) paradigm.

i) The epistemological role of "homo economicus" and "equilibrium" in the analysis of market functioning.

Objectivism in neo-classical economic analysis is conveyed through simplified assumptions about the conduct of individuals and the behaviour of markets. These are expressed by heuristic notions of "homo oeconomicus" and "equilibrium". The first notion refers to the set of assumptions made about the conduct of each individual interacting within the social system (i.e. markets), whereas the second refers to the overall functioning of the social system.

In the first place, the homo oeconomicus is merely a mental device for simplifying the complexity of human action into a few traits which enable an easy explanation of the causes of social phenomena. Homo economicus reduces human action and specifically reduces the choices undertaken by individuals in the market to a determinate exercise within a given ends-means framework, very much like the conduct of an automaton.[63] In this way, market players are detached from their natural ignorance about the circumstances that would otherwise influence their behaviour.

In the second place, equilibrium is also a hermeneutic construct used as a device for understanding market interaction.[64] The concept of equilibrium expresses reality by describing what the world would be like in the absence of fuzzy notions like "institutions" or "social culture" whose inclusion in the models would make them too complicated to adapt reality for the purpose of analysis. Under this ideal, economic interaction is

63 P. Boettke, "Where did Economics go Wrong? Modern Economics as a Flight from Reality", 11 Critical Review (1997), p. 20.

64 On the notion of equilibrium in general, see F. Hahn, Equilibrium and Macroeconomics, (Cambridge, Ma: M.I.T. Press, 1984), pp. 43 et seq. Also, P. Earl, Microeconomics for Business and Marketing, (Hants: Edward Elgar Publishing Ltd., 1995), pp. 309-312.

portrayed as tending towards a state of stability, which can be sorted out in advance by the observer through predetermined calculations.

Hence, equilibrium is characterised by two essential conditions: firstly, all participants in the system are assumed to possess all the relevant information necessary for them to maximise their utility; they have information of the present conditions in which economic actors interact (costs of available resources, endowments, prices, alternative offers, consumer tastes), as well as future conditions (opportunity costs, future events, future consumer preferences). Consequently, the competitive search for information on this data is irrelevant, because the neo-classical models take it as a "given". Markets are thus regarded as closed-end entities where the size and composition of the "pie" is anticipated, and entirely implicit in all given resource endowments, preference rankings, and relevant technological possibilities, which serve as data for the system at any specific time.65 Secondly, the epistemology of equilibrium rejects the idea of "on-going change" within the system. Prices, for example, are viewed as "parametric", as they convey only *past* information of existing resources in need of allocation.66

Equilibrium theories of markets assume that they clear out instantaneously; hence the passage of time and endogenous change and flux is denied *ex definitione*. Appraising economic change from this perspective is only possible by comparing the initial and final equilibrium end-states; the conventional analysis does not explain *how* the transition actually takes place. Indeed, such changes are viewed as being induced by exogenous causes. Therefore, at both the initial and final states, where equilibrium is present,

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65 As Kirzner indicates: "The emergence of this aggregate output is seen as inevitable, given this data. This is the case because the outcome of each buying, selling, and production decision is, as noted above, completely determined by these data. These outcomes are, for each decision-maker, merely those bundles (of inputs or outputs) ranked highest among the respective ranges of alternatives spelled out by the known prices and known budget constraints". (Kirzner, Discovery..., p. 14.)

66 Lavoie initially argued the non-parametric nature of the information conveyed by prices in his discussion about the "socialist calculation debate." (See D. Lavoie, Rivalry and Central Planning: The socialist calculation debate reconsidered, Cambridge University Press, New York, 1985.) Also, Thomsen undertakes an extensive comparison between parametric and non-parametric prices. (E. Thomsen, Prices and Knowledge, Routledge, London, 1992, Chapter 3)

decisions made by market participants have somehow all been made to fit in with each other.[67]

As Addleson notes, this epistemology draws the theorist away from understanding the world around him, simply because it postulates his omniscience.[68] A perception which advocates a close-ended perception of social phenomena, under which the observer can measure the extent to which these forces influence social outcomes because he is assumed to possess all the relevant knowledge and information on their importance and meaning, does not really demand any endeavour from the analyst to apprehend its essence, only to calculate its outcomes as he would anticipate all the possible moves in a game of chess.

Moreover, the assumption of omniscience leads the analyst to presume not only knowledge of all disclosed information shared by market players, but also knowledge of information that is missing amongst them. In this way, market players would be expected to work their way through the best contractual arrangements to eliminate any information

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67 In the words of Kirzner: "[Under neo-classical equilibrium models], market activity is seen as made up of innumerable independently made buying and selling decisions, each of which, in effect, more or less correctly anticipates and takes account of, all the other decisions being made in the market. Even though it is not claimed that each decision-maker is aware of all market prices and thus in effect correctly taking into account all relevant decisions (since market prices are held to reflect those decisions), what an individual chooses, in this view of things, is the best out of an array of clearly perceived alternatives. These alternatives are, so to speak, offered by the market. Given the prices of all available goods, each decision-maker can translate his available budget into an array of alternative market baskets. These baskets are, as it were, laid out in front if each decision-maker, available for his choosing. These alternatives are known to be 'there'. They are not discovered to be there; they are implicit in the known budget constraints and known arrays of market prices. From these alternative market baskets available to him, each decision-maker selects the one he most prefers. This selection constitutes the set of purchases and sales that he then makes in the market. (...) Every attempted purchase is successful; every attempted sale is successful. All items for which a possibility of sale exists at a price that will make both buyer and seller better off (in their own prospective judgement) are in fact so sold. In this picture of the market there are no surprises, no pure profits, and no pure losses. *There is nothing that is not, in effect, fully known at all times; there is no scope for discovery*". (Author's italics) (Kirzner, Discovery..., pp. 10, 13-14.)

68 M. Addleson, Equilibrium versus Understanding: towards the restoration of economics as a social science, (London: Routledge, 1995), p. 43.

asymmetry since it is assumed that they know how far real markets are from equilibrium.69

Finally, it is necessary to recall that as a mental device, equilibrium does not necessarily represent a unidimensional focal point from which the observer can examine reality. It can also denote multiple focal points, which strategic interaction amongst market players may lead to. In these cases, the analysis assumes the possibility of multiple equilibria.70 More recent developments in mainstream economics point in that direction thus bringing a sense of motion into the analysis of static equilibria.71 However, it is necessary to insist that in neither case is the conventional epistemology altered: equilibrium remains an ideal focal point (or points) of reference from which reality is contrasted. Hence, the formation of beliefs amongst individuals which is ultimately responsible for inducing entrepreneurial action and therefore brings about change within the system, remains left aside.72

All human conduct as it exists in real life is disregarded for the sake of concentrating the analysis on the anonymous interactive forces of supply and demand. Entrepreneurs are replaced by a group of contrived perfect forecasters who are able to calculate utility maximization at every moment in an ideal world of given constraints. This theory of choice neglects all considerations with regard to human action, as well as the fact that individuals act to achieve certain goals and objectives for which they make plans that are implemented in the context of irreversible time changes.

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69 On this question, see N. Foss, Firms and the Co-ordination of Knowledge: some Austrian Insights, DRUID Working Paper No. 98-19, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1998, pp. 9-13.

70 Foss explains how Game Theory today represents the dominant trend in the development of mainstream economics during the last two decades. In his words, "[G]eneral equilibrium theory died and game theory to a very large extent took over as the foundational approach of modern mainstream economics." (N. Foss, Austrian Economic and Game Theory, DRUID Working Paper No. 98-28, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1998, p. 1.)

71 Foss, Id.

72 Foss, Id. p. 16.

ii) The view of markets and economic organisation through the appraisal of the SCP paradigm.

We have so far highlighted how the use of the word "individuals" and "markets" in neo-classical equilibrium models could be quite misleading: how no real individuals are considered, only mathematical relationships which express the interaction of anonymous market forces.

Similar caveats apply in the appraisal of economic organisation and the institutions created under conventional analysis. This analysis, including the understanding of the law and firms which it evokes, is discarded as a source of unnecessary complications to the "clean" conclusions drawn from market interaction under the neo-classical premises of complete information. Institutions can only be explained as mechanisms devised to cope with uncertainty and change, both of which are denied in the neoclassical analysis; therefore, their presence in models of equilibrium is disturbing. Hence, the neglect of the firm, which remained a "black box" within economic analysis. Nor it is surprising that the study of social institutions by mainstream economics was delayed for so long.73 By separating "facts" from "values" conventional economic analysis had to sacrifice much of what is present in real markets.

These considerations are particularly relevant for understanding what exactly is involved in the appraisal of neo-classical economics and conventional regulation towards the behaviour of firms in the market. The perception of interactive firms in this appraisal

73 It is possible to trace this research project back to Ronald Coase's seminal work "The Nature of the Firm", (4 Economica n.s. [Nov. 1937]: 386-405) later restated in "The Problem of Social Cost" (3 Journal of Law and Economics, [1960]: 1-44.) Coase emphasised that the origins of market and legal institutions could be derived from the transaction costs of using market mechanisms. With no transaction costs, there would be no need for firms, as spot markets would co-ordinate production. Similarly, property law would be unnecessary in a zero-transaction-cost world, since as long as individuals are free to transact, resources would be allocated amongst those who valued them the most. (On this question, see Boettke, What Went Wrong with Economics? at 21.) In addition, Foss argues that the reason for the neglect of the firm theory (a widespread attitude that extended until the 1970s) is explained in the shared conviction that the purpose of economic theory is to primarily explain market level phenomena, while the firm is at most an intermediate step in the price theoretic logic. (See N. Foss, Austrian Economics and the Theory of the Firm, DRUID Working Paper No. 98-13, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1998, p. 2)

is misleading, for what is implied in the analysis is only an idealised interaction of calculated variables which possess no resemblance whatsoever to what is actually going on in real markets. However, perceptions are essential for understanding reality, as Loasby contends. What, then, is the conventional understanding of markets arising from the perception of equilibrium?

In the conventional analysis, markets are visualised as more or less defined *structured entities*, whose outcomes depend on the way in which business interaction and corporate strategies combine within concentrated structural market settings. This idea is epitomised in the so-called "Structure-Conduct-Performance" (SCP) paradigm. This notion provides a theoretical base from which it is possible to appraise how the interaction between market structure and business conduct influences market outcomes.74

It is difficult to conceptualise the SCP paradigm, given its theoretical reformulation over time. But the basic thrust of the paradigm rests on the idea that firms aim to acquire *market power* or a *dominant position* from which they can comfortably make an attempt at monopoly.75 In this appraisal, the presence of significant entry barriers is crucial, as it

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74 The *conduct* of firms within the market refers to the various strategies firms may pursue, either independently or collusively, in order to achieve their business goals. These include alternative profit-maximising strategies with respect to prices, product differentiation, and research and development as well as the possible pursuit of a variety of objectives other than profit maximisation. The *structure* of markets depends on the number of firms, diversity of size, market share, level of product differentiation as determined by price elasticity of market demand, level of integration among firms, as well as their conglomerate diversification, and finally the presence or absence of entry barriers. Finally, *performance* refers to the overall goals of the economic organisation, namely the pursuit of allocative efficiency. To a lesser extent, the notion of performance also covers other sorts of efficiency. (R. Clarke, Industrial Economics (Oxford: Basil Blackwell, 1985), p. 2.)

75 "Market power" and "dominance" denote a situation in the market where a market actor, due to its economic might, may disregard any potential or actual competition from other participants. However, there are slight differences between these two terms. Most commonly "dominance" is associated with the freedom enjoyed by a firm from the constraints of competition, or the control it wields over upstream or downstream trading partners. Generally, competition laws relying on this concept do not prevent suppliers from holding a dominant position but merely from abusing that position. Monopolists do not have to achieve a pure or quasi-pure monopoly in the market concerned; they only have to eliminate sufficient competition to be able to impose a monopolistic price increase. Moreover, *dominance* is a concept influenced by political considerations of "fairness"; hence the antitrust schemes that follow the criterion of dominance tend to stress the need to preserve multiple independent outlets rather than to achieve economic efficiency, which could eventually diminish multiplicity in favour of fewer, yet more efficient firms in the market.

allows incumbent firms to undertake restrictive practices, and maintain supra-competitive (i.e. monopolistic) prices, either separately or jointly, with other firms, aided by market power. Under this perspective, firms within competitively atomistic, structured markets have virtually no conduct options; they are "price takers". A competitive market structure determines that the firms will be price takers and cost-minimisers (or profit-maximisers). This price-taking behaviour in turn results in superior market performance. However, firms in highly concentrated markets can take advantage of a variety of conduct options, many of which may yield very poor market performance. Collusive output restriction in search of higher profits would be a prime example.

The pervasive influence initially attached to entry barriers would suggest that in concentrated markets, incumbents would be easily able to impose monopolistic conduct without the threat of facing new competition. Under the influence of this appraisal, antitrust doctrines had been developed under the assumption that certain market structures, due to their concentration (induced by the presence of considerable entry barriers), encouraged firms to restrict output. A firm could grow indefinitely until it became a "monopoly", thus developing "market power". Once a monopoly position was achieved, the firm would be able to restrict output, increase prices, or harm rivals. Thus, market concentration was made primarily responsible for market competitiveness. In other words, a connection was developed that linked overall market performance with the resistance of the market in question to the entry of potential newcomers as determined by the existing entry barriers.

Later versions of the paradigm emphasise "dynamic" factors, such as firms' strategies, as valid explanations for market performance. These "dynamic" models of competition present more flexible hypotheses about the interaction between markets and firms' strategies, which attempt to incorporate the numerous cases showing an apparent

By contrast, the concept of "market power" has been fully developed under industrial organisation theory and is therefore politically "more" neutral. Boner and Krueger define market power as "the ability to vary price without suffering large variations in sales, fundamentally due to a lack of alternative products". (Boner and Krueger, p. 10.) However, the differences between the notions of market power and dominance are more apparent than real and in practice they tend to merge in policy enforcement.

lack of connection between concentration in an industry and the level of profits of the most significant firms.76

In particular, the new evidence has shown that there is no fatalistic connection between market concentration and business rivalry, as seen in cases where the most concentrated industries are not necessarily the most profitable.77 These conclusions are

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76 For example, Caves and Porter analyse the strategic behaviour of incumbent firms in the market. According to their view, the "deterrent" to new firms is not simply the result of barriers to entry that allow incumbent firms to use pricing limit strategies. Firms displayed a complex array of dissuasive techniques to impede newcomers from entering the market, creating new entry barriers. The new theory admitted that the conduct of incumbent firms could alter market structure. Under this appraisal the role of strategic groups in the structure of markets is decisive. Therefore, the concept of barriers to entry has been broadened to include barriers to mobility. The theory holds that modelling the entry process in oligopolistic industries will be as difficult as modelling the price and output behaviour of entering firms. Interdependence exists between incumbent firms and potential entrants just as it does among incumbent firms. Entering firms and potential entrants must second-guess one another and make significant decisions based solely on conjecture. Theoretical game approaches are, therefore, as central to explaining the entry process as they are to explaining behaviour amongst entering firms. For this reason, considerations of conduct must be broadened to include more detailed investigations of entry-deterring strategies. (Burton, Competition..., pp. 1-23.) For example, experience curve pricing as an entry-deterring strategy shows that firm conduct determines market structure. The outcome of this strategy is to gain a dominant position in the market concerned.

77 For example, Hay and Werden contend: "It is desirable to have an empirical basis for merger policy, and until the mid-1970s most economists probably believed that inter-industry concentration profits studies provided that basis. These studies have since been attacked on many fronts, and few economists continue to believe that such studies provide a substantial basis for merger policy". (Hay and Werden, G., Horizontal Mergers: Law, Policy, and Economics, 83 American Economic Review, [1993] at 174.) According to Werden, the overall thrust of empirical literature on market concentration and the level of prices shows that there is a relationship that is positive and statistically significant, but "typically not particularly important quantitatively". (G. Werden, A Review of the Empirical and Experimental Evidence on the Relationship between Market Structure and Performance, United States Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper, EAG 91-3, Washington, DC, May 1991, p. 1) Carlton and Bishop consider that: "There is indisputable evidence that prices fall as entrants enter a previously monopolised market. The real debate is how fast price falls with entry. Studies of individual industries seem to indicate that competition often works very quickly, with large price effects caused by entry of a second or third firm, but much lower (and sometimes zero) effects for subsequent entry". See C. Carlton, and W. Bishop, "Merger Policy and Market Definition Under the EC Merger Regulation", in Antitrust in a Global Economy, B. Hawk, (ed.), (Irvington-on Hudson: Transnational Juris Publications, Inc., 1994), p. 415. In short, the new evidence shows the following: firstly, there is no long-run empirical relationship between high profit and high industry concentration; secondly, accounting profits are a poor indicator of monopoly or resource misallocation; and finally, long-run profits are a return to long-run innovation and risk taking. In other words, it is reasonable to expect that less efficient firms will grow more slowly than their more efficient rivals.

supported by further empirical evidence of the behaviour of rivalry itself, which shows that cartels are not as stable and profitable as they were thought to be.[78]

Furthermore, new explanations for entry barriers arose, whereby they were viewed as efficiencies that ought to be protected, rather than discouraged by blind intervention.[79] Finally, the theory of Contestable Markets eroded the significance formerly attached to entry barriers as determinants of performance and the contestability of markets as determinants of market outcomes.[80]

In short, these more recent models induced antitrust enforcement to become more sophisticated, incorporating business behaviour explanations to justify the working of the SCP paradigm on modelled situations which were assumed to be closer to *real* markets.

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78 The alleged readiness of firms to enter into these arrangements is more limited than was thought. Indeed, firms are unlikely to join these agreements due to their unstable character, and prefer to co-operate by other means. Due to the financial risks involved, the empirical evidence presented suggests that this form of co-operation is seldom profitable. Asch and Seneca made an empirical analysis on the role of collusion in the profitability of American manufacturing corporations during the period 1958-1967. Although they were cautious about the implications of their evaluation, they concluded that the collusive firms are consistently less profitable than non-colluders. (See P. Asch and J. J. Seneca, "Is Collusion Profitable?" in The Causes and Consequences of Antitrust: The Public-Choice Perspective. F. McChesney and W. Shughart (eds.) (Chicago: The University of Chicago Press, 1995), pp. 107-117.

79 For example, Stigler excluded economies of scale from the concept of barriers to entry. He argued that these include any feature of a market that imposes costs on entrants, which incumbent suppliers did not face when they entered the market. See G. Stigler. The Organization of Industry, (Chicago: The University of Chicago Press, 1983), Chapter 6. As Rothbard contended, the fact that these barriers were not present at the time the first entrants penetrated the market, does not necessarily involve a higher cost for incoming firms. (Rothbard, "Monopoly...")

80 W. Baumol, Panzar and R. Willig, Contestable Markets and the Theory of Market Structure, (New York: Harcourt Brace Javanovich, Inc., 1982). W. Baumol and A. Blinder Microeconomics: Principles and Policy, 5th. Ed. (New York: The Dryden Press, 1991). pp. 324-325. Market performance will be "competitive" (i.e. cost-efficient market structure will evolve and firms will earn zero economic profits in the long-run) regardless of the degree of concentration in the market, as long as it remains "contestable"; that is, as long as barriers to entry are low. Contestable markets, like competitive ones, exist in the absence of entry barriers or exit. In contestable markets incumbent firms will be forced to charge prices which reflect their costs of production due to the threat of competition from outside, as long as entry conditions are insignificant. A distinctive sign of contestable markets, therefore, is that they may be highly concentrated due to significant economies of scale or economies of scope, and still be open to competitive pressure from potential competitors. The theory of Contestable Markets is closely related to the theory of Competitive Markets.

Nevertheless, the new models explaining the causality of market phenomena under the SCP paradigm share a similar closed-end appraisal of market interaction with the old ones. Both assume that the policy-maker is fully informed in understanding the way in which the integrating elements of the SCP paradigm allegedly influence one another, as well as the social efficiency which is assumed to accrue by the manipulation of these elements according to a predetermined pattern.

These "dynamic" models relax the assumption of perfect information under a single equilibrium, by exploring situations in which there is asymmetric information amongst economic agents which leads to multiple equilibria. In recent models, for instance, the tools of Game Theory are used to examine the likely response of firms to the anticipated strategies of other market participants.[81]

Nevertheless, in these models it is still assumed that the decision-maker has access to all the information necessary to predict the market outcomes resulting from the interaction, and to anticipate likely outcomes, regardless of whether the interacting firms possess asymmetric or perfect information.[82]

In conclusion, the counterfactual use of positive models led to believe that reality would be located at some intermediate point between the two extremes depicted by the Pure Monopoly and the Perfect Competition models. If these two polar references were opposite ideals, could it be possible that models which possess none of their extreme assumptions (i.e., perfect information) be closer representations of "real" markets?

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81 For example, current antitrust analysis game-theory modelling to demonstrate how firms may "co-operate" through tacit collusion. (E. Ullmann-Margalit, The Emergence of Norms, (Oxford: Clarendon Press, 1977); also, Burton, Competition..., pp. 1-23.) In general, see L. Phlips, Competition Policy: A Game Theoretic perspective, (Cambridge: Cambridge University Press, 1995).

82 Foss observes that "the new game theoretical industrial organisation (IO) may be seen as an advance relative to the old-fashioned structure-conduct-performance" (Foss, Austrian Economic and Game Theory, pp. 1-2) Nevertheless, he is very careful in pointing that the new appraisal does not really represent a paradigmatic departure from mainstream "equilibrium" economics, but simply a "dynamic" improvement over the former static bias dominating the explanation of conventional market behaviour.

Not surprisingly, scholars developed intermediate models to express the many ways in which "asymmetric information" (i.e., imperfect information) caused markets to behave with the characteristics of neither polar extreme. Strongly influenced by their positivistic perspective, scholars never questioned whether the theories were accurate, logical descriptions of reality.

c) Normative implications of the "market failure" logic on the view of markets and economic organisation.

Initially, the positive method induced scholars to make counterfactual experiments whereby the positive function of real world market institutions was contrasted with the perfectly competitive market. The contrast of the imaginary world of equilibrium against the real world of firms and markets showed how these institutions have some sense in enabling market participants to cope with incomplete information. In this way, they could draw "factual" conclusions on market functioning, by avoiding the treatment of institutions in the analysis, which centred on "values".

However, it was a short step before economists would deduce normative conclusions from this counter-factual use of equilibrium. They soon realised that optimal efficiency in the allocation of resources would prevail in markets under perfect competition, and that this state of equilibrium within the system would prevail.[83] Under these conditions market forces would allocate social resources amongst individuals where they would obtain their maximum value. "Resources gravitate to those uses where their economic value is greatest."[84]

83 Sen, p. 31; also, Veljanovski, p. 20.

84 Veljanovski, p. 20. In the closed-end world of equilibrium this reference was inevitably linked to resource allocation. As Richardson states: "Formal welfare theory is concerned essentially with the logic of resource allocation; it sets itself to find what distributions of resources satisfy a stipulated criterion while being consistent with certain postulated objective conditions, such as preferences, production functions and the like". (G. B. Richardson, Information and Investment, (London: Oxford University Press, 1960), p. 123.) In this way, allocative efficiency, as embodied in the Pareto optimal formulation, gained a paramount position amongst social scientists as the organising principle of normative economics. (A. Sen, On Ethics and Economics, (Oxford: Basil Blackwell, 1987), p. 33.)

Thus, the neo-classical view not only brought about a positive perspective of market forces, but also provided a normative reference from which market performance could be judged. Economists either idealised reality itself, so that it approximated the model, or made reality a dystopia, with utopian properties attributed to those interventions designed to make reality match the model.[85]

Achieving equilibrium thus became crucial to the normative appraisal of the notion of market competition. If the appropriate conditions of equilibrium hold (i.e. perfect information, decentralised markets, many buyers and sellers) the market mechanism yields the best possible welfare results. As Boettke explains, this created the setting for the "market failure" logic, because "unless the strict conditions required for general competitive equilibrium were met, the economic theory could not, with any confidence, make pronouncements about the efficiency of market allocations. In fact she could be confident that the market would yield suboptimal results that demanded corrective government action."[86] Equilibrium is only possible in decentralised market structures where competition is so "perfect" that individual firms, unable to manipulate market conditions to their own advantage, behave as "price takers". That is, no one can act independently but only in reaction to price changes. Under this view, demand elasticity provides markets with their particular shape.

The idea that under equilibrium resources could be allocated so as to maximise consumer welfare to the limit of current budget constraints, was too tempting to be neglected. It soon became a normative reference for measuring how "well" (i.e. efficiently) a market was structured. Economists were lured into the idea that markets alone cannot fulfil a social welfare function, conferring benefits on society as a whole, because they can never attain equilibrium or perfect competition. Any state of disequilibrium seemed a "failure", even to those who did not share the normative

85 Boettke, "What Went Wrong with Economics?" at 20.

86 Id.

properties of the economic efficiency standard. "Market failure simply means the failure of real world markets to achieve the standards of the imaginary market."87 It is utterly impossible to achieve an efficient resource allocation outside positive equilibrium models.88 In particular, it presents the idea that markets can reach a "social optimum" if they move towards equilibrium. This idea haunted policy-makers, who naively believed that through appropriate legislation they could make "reality" approximate and even replicate such an optimal state.

These considerations are important because they laid the path of research in the study of competition. Initially, Pietro Sraffa argued that markets had obstacles to competition which made it impossible to attain competitive equilibriurn in the long-run. These obstacles were not simply "frictions", as defenders of the competitive model dismissively claimed. Instead, they represented important forces with lasting effects. His approach to these obstacles to competition (viz., possession of unique natural resources,

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87 W. Mitchell and R. Simmons. Beyond Politics: Markets, Welfare and the Failure of Bureaucracy, (Boulder: Westview Press, 1994), p. 6.

88 Here, it is essential to refer to the influential work of Arthur Pigou on social costs and negative externalities created under market functioning. This work explicitly conveys the idea that government intervention could improve the overall efficiency of social performance. Alfred Marshall in his Principles of Economics had already introduced the concept of external economies, but little attention was given to it until his disciple, Pigou, pointed out the divergence existing between "private net product" and "social net product". Pigou argued that the exchange process could lead to externalities or diseconomies; namely, a situation where the costs inherent in any activity (i.e. the costs for private parties) could diverge from their social costs (i.e. the costs falling upon such agents and the rest of society). Pigou called "external cost" or "external diseconomy" the difference between the social and private cost. Similarly, the difference between social benefit and social costs led to "external benefits" or "external economies". Pigou observed that each individual adopts his decisions on the basis of the private costs and benefits of his undertaking. In other words, he exclusively considers the costs and benefits affecting him. The rational individual does not consider these external "effects", regardless of their costs or benefits. Not all the costs and benefits of individual trades are necessarily internalised by the traders. Some benefits and costs may leak and affect the behaviour of other individuals who are not a direct party to the exchange. Transactions within the market may impose externalities and therefore lessen social efficiency; thus, government intervention would be desirable in those instances. This approach initiated the branch of Welfare Economics in economic theory and had a deep influence on the perception of markets. Later, Ronald Coase demonstrated the fallacy of the unilateral approach followed by Pigou in establishing externalities. In essence, Coase argued the two-way nature of externalities. For an explanation of how Marshall's perspective was developed by Pigou and later criticised by Coase, see R. Ekelund and R. Hébert, A History of Economic Theory and Method, (New York: Mc Graw Hill, 1990), pp. 403-405. For an explanation and critique of the Pigovian contribution, see S. Cheung, The Myth of Social Cost: A critique of welfare economics and the implications for public policy, (London: Institute of Economic Affairs, 1978.)

legal privileges, control of a large share of total production, existence of rival commodities) inspired J. Robinson's approach to imperfect markets.[89]

This normative appraisal fuelled the conviction amongst scholars that the closer market structure was to a state of perfect competition, the more likely it was that allocation would be "optimal". Conversely, in markets that did not resemble these extreme structural conditions; that is, all real life markets, competition was classified as "imperfect" or "monopolistic". Armentano explains this reasoning in more detail: "Between 1880 and 1933 economists defined and constructed mathematical models to encompass a theoretical business competition in terms of a particular *market structure* (...) But why *this* definition of competition? This particular definition of competition was popular with economists, and especially with the mathematical economists, because it implied a certain conduct-performance from economic markets that economists came to regard as 'optimal'. In a word, a purely competitive market structure would automatically generate economic forces that tended to maximise society's wants at the least possible cost: it was the most *efficient*. Accordingly, pure competition became the rationale for laissez-faire; departures from pure competition became the rationale for antitrust".[90]

The logic of antitrust policy emerges out of this epistemological perception of reality and the instrumental role of regulation. *Market imperfections* required government

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89 Ekelund and Hébert, pp. 485-486, 495-507. The work of Marshall's disciples was a decisive factor in turning the concept of externalities into normative yardsticks. Noticeably, in her famous book, *The Economics of Imperfect Competition*, Robinson explicitly devotes a whole chapter to relate the notions of "imperfect markets" and "negative externalities" one each other. In this chapter she attaches normative properties to her positive findings about some states where competition does not replicate perfect competition. On this question, see J. Robinson, The Economics of Imperfect Competition, (London: Mac Millan & Co. Ltd., 1942), pp. 307-326. It is also fair to say that Robinson herself was well aware of the risks of misusing equilibrium as a heuristic tool, when she declares: "In order to make a valid theoretical comparison between competitive output and monopoly output in a particular industry it is necessary to make very severe assumptions (...) *These assumptions are unlikely to be fulfilled in any actual situation*". (Robinson, The Economics..., pp. 143-144.) (Emphasis is the author's). In developing his ideas about monopolistic competition Edward Chamberlin followed an independent line of research to Robinson's, but remarkably his studies pointed to similar conclusions. Markets showed several instances of monopolistic competition, which prevented an optimal allocation of social resources. (Ekelund and Hébert, pp. 486, 488-495.)

90 D. T. Armentano, The Myths of Antitrust: Economic Theory and Legal Cases, (New Rochelle: Arlington House, 1972), p. 27.

intervention to offset the negative externalities on competition processes depicted in these models. Improving competition required active antitrust enforcement to eliminate shortcomings such as collusive behaviour, or excessive concentration or monopolisation resulting from poor market structure.

Competition was made 'perfect'; no reputable economist claimed that such a system accurately described the actual state of free enterprise. However, as Richardson put it "it undoubtedly stood, for many people, as an ideal or model form of organisation –strictly speaking only a logical as opposed to an ethical ideal, although this distinction was not always sharply made. It does not seem to have been recognised that the fact that 'imperfections', in some forms and degree of strength, are clearly an obstacle to adjustment, does not entitle one to conclude that it would be best if (market) 'imperfections' were absent altogether. Yet the pedagogic convenience of perfect competition, and its suitability as a base for extensive formal and mathematical elaboration, gave the system a central place in theoretical discussion".91

In this connection Stigler observed that "definitions do not yield any knowledge about the real world, *but they do influence impressions of the world.* If only markets with a vast number of traders are perfectly competitive, and if markets with few traders are

91 Richardson, Information ..., at 39. Klein emphasises the importance of the perfect competition model for antitrust purposes as follows: "(...) of all the various analytical toolkits that constitute contemporary political economy, perhaps the most important model for the economist is the model of perfect competition". B. Klein. "The Use of Economics in Anti-trust Litigation: Realistic Models of the Competitive Process" in The Law and Economics of Competition Policy, F. Mathewson et al. (eds.) (Vancouver: The Fraser Institute, 1990), p. 420. Also, Clark argues: "The conception of 'perfect competition' has itself for the first time received really specific definition and elaboration. With this has come the realisation that 'perfect competition' does not and cannot exist and has presumably never existed (...) *What we have left is an unreal or ideal standard which may serve as a starting point of analysis and a norm with which to compare actual competitive conditions. It has also served as a standard by which to judge them*". (Author's italics) (J. M. Clark, "Toward a Concept of Workable Competition", 30 The American Economic Review, [June 1940]: 241). Finally, Hayek indicated with regard to the perfect competition model that: "This ideal case (...) came to be regarded as the model and was used as a standard by which the achievement of competition in the real world was judged". (F. A. Hayek, Law, Legislation and Liberty: The Political Order of a Free People, Vol 3 (Chicago: The University of Chicago Press, 1976), p. 66.) A recent analysis on the use of perfect competition as a normative yardstick is found in J. Burton, "Competition over Competition Analysis: A guide to some Contemporary Economics Disputes", in Frontiers of Competition Law (Birmingham: Institute of European Law, 1994.)

called oligopolistic (literally, "few sellers"), that suggests that these latter markets are not competitive, as well as not perfectly competitive. [Consequently] The suspicion of small numbers was gradually reinforced by the antitrust cases". (Author's italics)92. In the hands of his disciples Marshall's positive concept of externalities suddenly turned into normative yardsticks.

Under these assumptions, all forms of co-operation and economic organisation amongst entrepreneurs implicitly entail a departure from the optimal frontier, because they produce some relaxation of the conditions encapsulated in the Perfect Competition Model. They also indicate some kind of externality or market failure which creates an asymmetry of information to the disadvantage of someone in the market, whether it be the consumers or other producers.

In the language of the SCP paradigm, economic organisation was assumed to be based around the monopolistic intentions of firms with "market power". Similarly, concentrated markets immediately became questionable, as they appeared to favour all sorts of trade restrictive dealings. This is especially important in understanding the fixation of Latin American antitrust scholars with issues such as market concentration, as we shall see below.93 As Richard Epstein claims: "On the [neo-classical] *economic view of the world* it is quite a mistake to view competition and monopoly –or at least monopolization– with a detached neutrality, as two alternative social states that ebb and flow as the tides. Monopolization is regarded as an improper social activity, one that is to be prevented chiefly by the civil and criminal sanctions of the antitrust laws." (Author's italics)94

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92 See Stigler, Memoirs..., p. 94. Richardson also observes: "there is no reason to expect that the hypothetical market conditions which define perfect competition would in fact ensure that production would be carried on by the most efficient means, for there is no reason to believe that the supposed equilibrium position would ever be reached. The link between market structure and the scale of investments is to be sought more in the particular modes of adjustment, than in the supposed equilibrium situations, with which the structure can be associated. Here, as elsewhere, much that is of importance has been denied adequate analysis as a result of the tyranny which the equilibrium concept has exercised over modern economic theory". (Richardson, Information..., p. 89)

93 See section 2.2 in this chapter.

94 R. Epstein, "Private Property and the Public Domain: The Case of Antitrust", in Ethics,

The severe implications resulting from having this standard enforced at every instance logically forced regulators to realise very quickly that not all "co-operation" was socially harmful. This became evident once the initial structural versions of the SCP paradigm were challenged by empirical evidence pointing to "dynamic" explanations, and people came to view many restrictions as "efficiencies".

Antitrust regulations solve these complications in the so-called "per se" and "rule of reason" analysis. Certain conduct and corporate forms are "per se" regarded as entailing a monopolistic intention, since there are no justifications reasons for firms undertaking them except to restrict business rivalry in order to impose consumers with higher prices and other unjustifiable market conditions. Therefore, legal rules prohibit them with no exemption. Sometimes, however, these businesses conduct and practices may prove necessary to enable the system to develop "social efficiencies"; this conduct should not be forbidden, but subject to a "rule of reason" analysis. The task of such analysis is essentially to make inferences on the intentions of firms entering into these practices, in order to distinguish monopolistic from efficient market outcomes.

The thrust of antitrust regulations revolves around the idea that proper appraisal of the elements comprising the SCP paradigm can give the policy-maker sufficient knowledge to improve social performance. That posits the question of how social performance is defined, which is ultimately a problem about the public interest goals sought under these regulations.

Economics and the Law, Nomos XXIV, J. R. Pennock and J. Chapman (eds.). (New York: New York University Press, 1982), p. 52. Epstein does not escape from implicitly endorsing the normative consequences of antitrust. Therefore, he justifies antitrust action on the *assumption* that consumers pay more than they *should* in monopoly markets, due to illegitimate monopolist coercion: "The dangers of monopoly have led to powerful legal restraints against freedom of contract for private parties under both the Sherman and Clayton Acts". (R. Epstein, Bargaining with the State, (Princeton: Princeton University Press, Princeton, 1993), pp. 51, 53.) Similarly, Rothbard argued that: "many writers have used [Consumer Sovereignty] as an ideal with which to contrast the allegedly imperfect free market system" and further, the notion has been used as an "ethical ideal against which the activities of the free market are to be judged. Consumer Sovereignty becomes almost an Absolute Good, and any action by producers to thwart this ideal is considered as little less than moral treason". (M. Rothbard, "Monopoly and Competition", in Man, Economy and State: A Treatise on Economic Principles, Vol. II, (Princeton: D.Van Nostrand Company, Inc., 1962), pp. 561, 562.)

d) The definition of "public interest" goals under conventional regulation.

Determining the "public interest" goals of any legislation under the conventional legal method is not an easy task. The method does not provide us with a reliable way of determining the intention of the law-giver beyond a superficial analysis of the wording of legal rules. For this reason, certainty in the law has been construed as "the precision of a written text emanating from legislators".95 To avoid the limitations of the conventional legal method it is necessary to trascend these narrow boundaries in order to ascertain the sense and public goals of conventional regulation. It is here that one can find the ultimate normative sources of antitrust regulations *justifying* their enforcement.

These sources are found, again, in the distinction between "fact" and "value" inherited from positivism. Notwithstanding its allegiance to "value neutrality", positivism tended to obscure the distinction between facts and values by virtue of its "formalism", which tended to conflate modelling and aesthetics. Indeed, as we have seen, positivism induced a confusion between the perspective of the observer with the perspective of those players belonging to the observed reality.96 Hence, it was difficult for positivist social scientists to escape taking a position on values in their positive appraisals of reality.97

Despite the considerable appeal of this culture which has pervaded economic science for two centuries, it has not been widely acknowledged by legal scholars.98 As a

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95 B. Leoni, Freedom and the Law, (Indianapolis: Liberty Fund, 1961). p. 93.

96 See section 1.1.a) above.

97 Katz explains why: firstly, social science studies a set of problems about which people has intense ethical feelings. Secondly, because of the language and rhetoric of moral philosophy which gave many technical terms a value-laden connotation in ordinary language (i.e. "equilibrium", "market failure", "perfect competition", etc.). Finally, theoretical modelling (particularly among economists) induced scholars to use rhetoric and examples to simplify and motivate the models; however, rhetoric (which is not appreciated as such by those without special technical training) necessarily reflects the normative commitments of the modeller. (Katz, "Positivism ..." at 2235-2236).

98 However, it is fair to say that legal science is much dominated by a positivist outlook, particularly with regards to the analysis of social rules through the analytical legal method. Legal instrumentalism is an important part of lawyers' professional tradition. However, on the normative side things are perceived differently. As Katz contends: "our legal culture regards

result, economists are frequently committed to values which are not clearly distinguished from their positive analyses. For this reason, economists' endorsement of a policy or a rule as "efficient" entails a complex descriptive statement that can only be solved with the help of a well-defined algorithm for checking its presence, which is not always explicitly specified. Thus, "efficiency" in economic analysis possesses different meanings, which cannot be ascertained unless the analyst states their normative sense in advance. In contrast, the comparatively milder influence of positivism on legal scholars makes them committed to a variety of values, particularly in the field of public law.99 These values, which economists regard as alien to their positive analysis, are essential to legal science; furthermore, their normative essence comes out of discussion.100

These considerations are essential for seeing why the formalist approach of legal science in public law did not really entail value-neutrality since "within the formalist

law as more than commands of an arbitrary sovereign; we expect law to be principled. Positivism is controversial because it suggests that we might in some sense be obligated to obey unprincipled laws." (Katz, "Positivism ..." at 2239). Indeed, in recent years, there are clear signs of a growing disenchantment with the construction of legal science as an empirical science. Evidence of this disenchantment is found, for example, in the new breed of constitutionalism emerging in Europe, which is moving toward a more effective protection of human and economic rights through judicial control. Still, European scholars highlight the diversity of national jurisdictions with regard to judicial control; as an ex-judge of the European Court of Justice argued: "it is in this area particularly that national interests show their differences". (Lord Mackenzie Stuart, The European Communities and the Rule of Law, The Hamlyn Lectures, Stevens and Sons, London, 1977, p. 64.) In Latin America, too, a process towards the inclusion of more effective devices for the procedural protection of constitutional rights has become dominant in recent years. These means range from preventive judicial review mechanisms to the specific right of *amparo*. See Brewer, Judicial... More generally in this regard, see E. García de Enterría, La Constitución como Norma y el Tribunal Constitucional, (Madrid: Civitas, 1985). In general, see the discussion between H.L.A. Hart and Lon Fuller

99 See Katz, "Positivism ..." at 2247. Loughlin also emphasises how such values are implicitly rooted at the heart of the basic institutions of public law. As a consequence of this, two basic styles of thought in public law emerge, which he labels "normativism" and "functionalism". Between adherents of these two styles, he argues "there is virtually *no agreement* over the contours and boundaries of the subject", and even if writers may use similar concepts –such as sovereignty, liberty, democracy, and law– the meanings which such concepts convey tend to be rather different. In his opinion, "this is hardly surprising since these concepts perform different roles within competing models of public law." In fact, the differentiation between them is deep, as "the roots of these competing styles are to be found in theories of politics and society". (Loughlin, p. 230.)

100 Thus, economists regard these values as "equity" considerations which do not serve as guidelines to economic science's positive analysis. An example of this is Rawls' minimax rule, which can hardly be regarded as a positive rule under legal analysis. (Katz, "Positivism ..." at 2237.)

approach there existed a specific ideological conception of legality."[101] What is that ideological conception in the sphere of market regulation and antitrust policy?

In some jurisdictions (most notably, the United States of America), antitrust is generally sought to protect consumer welfare; therefore, in our view, it should be exclusively guided by efficiency concerns. Consumers will be better off if enforcement obliges enterprises to lower their prices to meet their marginal costs. Hence, consumers must be "sovereign" in the sense that they are the ones who should dictate the terms of market transactions. Purposive legislation should ensure Consumer Sovereignty, and vague political concerns should be excluded from antitrust policy enforcement. Only by protecting consumer welfare is it possible to develop clear enforcement guidelines compatible with the rule of law and avoidance of discretion. Consumer welfare is the only legitimate goal of policy enforcement and indeed the only one in mind when the policy was introduced. To support this contention, "consumer welfare" scholars resort to selected cases decided by the U.S. courts (particularly, the most persuasive ones decided by the Supreme Court) which reveal an increasing departure from the former "political" or "structuralist" approach to the policy.[102]

Other jurisdictions often have rationales which are different from economic efficiency, probably persuaded by the criticisms made upon the Pareto standard.[103] These

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101 Loughlin, p. 23.

102 See in particular, R. Bork, The Antitrust Paradox: A Policy at War with Itself, Basic Books Publisher, New York, 1978.

103 Initially, the so-called Pareto criterion became the dominant expression of this kind of efficiency in the economic profession. Later, however, the standard was strongly criticised by welfare economists like Sen, who pointed out the harsh implications of enforcing it with no qualification: "Pareto optimality deals exclusively with efficiency in the space of utilities, paying no attention to the distributional considerations regarding utility. [Thus] the whole focus of analysis has continued to be utility. (...) It is, of course, possible to introduce *other* considerations in judging the success of persons and thus of the society. Pareto optimality captures the efficiency aspects only of utility-based accounting". (Sen, p. 33) Indeed, by leaving some people in extreme misery and others 'rolling in luxury' without violating the condition of efficiency, "Pareto optimality, like 'Caesar's spirit', 'comes hot from hell." (Sen, p. 32) Further, Veljanovski states that this criterion denies the possibility of making interpersonal comparisons of utility. Therefore, "the welfare of one individual cannot be offset or compared to that of another", which is an essential condition for appraising policy initiatives, because "even the most trivial policy change is likely to harm at least one person's interests". By impeding an interpersonal comparison of individual welfare the Pareto criterion runs counter to the logic of

alternative rationales generally defend the existence of a "higher" economic order whose workings take into account consequences in other realms of individual freedom. They consider economic concentration to undermine political freedom, and therefore the existence of democratic and free societies. For example, Ropke justifies antitrust rules on the basis of some "higher" good which is distinct from market functioning. In his words: "It is by no means enough to invoke the laws of the market in appealing to people's enlightened self-interest and their economic reason, for within certain limits, cartels, labour unions, pressure groups, and trade associations serve their members' interests very well indeed when they exercise monopoly power or pressure on the government's economic policy in an attempt to get more than genuine and fair competition would give them. There must be higher ethical values which can invoke successfully: justice, public spirit, kindness, and good will."104 For these scholars, antitrust policy should pursue "equitable" political objectives including, for example, the political union of markets in the process of economic integration; protection of the alternatives offered to the consumer; protection of less competitive firms, such as small and medium competitors; a challenge to economic power, and so on. Determining these objectives becomes a matter of discretion and political appraisal. Frequently, this view of antitrust policy-making is said to pursue the protection of competitors rather than competition itself. In the United States, "mainstream" antitrust scholars such as H. Hovenkamp, F. M. Scherer and E. Fox, amongst many others who belong to the so-called "structural" school of antitrust, support this view. In Europe, the Ordo-Liberal School of Freiburg defends an "integrated" view of the social order, which link both political and economic interaction. 105 These views are linked to a complexity of values involved in the design of regulation.

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public policy. To circumvent these problems, the standard was eventually replaced by the so-called Kaldor-Hicks efficiency standard, also called the potential Pareto improvement, hypothetical compensation test or cost-benefit analysis. Under this test, a situation is Kaldor-Hicks efficient if those that gain can, in principle, compensate those that have been "harmed" and still be better off. Therefore, it provides the theoretical underpinning for social cost-benefit analysis, which is at the bottom of antitrust normative analysis. (C. G. Veljanovski, "The New Law and Economics: a Research Review", in Readings in the Economics of Law and Regulation, A. I. Ogus and C. G. Veljanovski (eds.) (Oxford: Clarendon Press, Oxford, 1984), p. 20) For the purposes of this work, we shall simply call it "economic efficiency".

104 W. Ropke, A Humane Economy: The Social Framework of the Free Market, (Chicago: Henry Regnery Co., 1960), p. 124.

105 See, M. Streit, "Economic Order, Private Law and Public Policy: The Freiburg School of Law and Economics in Perspective", 148 Journal of Institutional and Theoretical Economics [1992]:

In this regard, Baldwin lists five sets of values which make sense of legitimacy claims on government rules: the legislative mandate claim; the accountability or control claim; the due process claim; the expertise claim and finally, the efficiency claim.[106]

Defining the goals of antitrust regulation has become quite intense, particularly in the United States, where the policy discussion has been rather technical in comparison to the European Union where political considerations have prevailed. "One of the fiercest and most persistent debates in American jurisprudence concerns the proper goals and objectives of antitrust policy. Such a debate is to a large extent absent from the antitrust policies of the EEC and the UK".[107]

In the end, the multiplicity of seemingly equal objectives suggests that choosing amongst social welfare standards is entirely a matter of discretion and taste, and that the whole debate is futile.[108] Indeed, it is necessary to realise that beyond the point of choosing between alternative social welfare goals, their ultimate source of legitimacy, is reliant upon whether they can materialise effectively in policy enforcement, as Baldwin contends. This depends, first and foremost, on whether they can be applied consistently: in other words, it depends on whether they can be structured in an effectively enforceable "rule of law". In the end, this is the ultimate normative requisite for legal rules, in both the traditions of legal positivism and moral theories of law. As Katz observes: "Both Hart

675-704. On the analysis of antitrust policy from the Ordo point of view, see W. Möschel, "Competition from an Ordo Point of View", in German Neo-liberals and the Social Market Economy, A. Peacock and H. Willgerodt (Eds.), (New York: St. Martin's Press, 1989), pp. 142-159. For an historical account of the influence of this school on European antitrust policy see F. M. Scherer, Competition Policies for an Integrated World Economy, pp. 28-30.

106 Baldwin, pp. 41-46.

107 T. Frazer, Monopoly, Competition and the Law: The Regulation of Business Activity in Britain, Europe and America, (New York: St. Martin's Press, Inc., 1988), pp. 1-8).

108 Adams and Brock have questioned the multiplicity of opinions on antitrust policy goals: "The debate has centred on the proper role of antitrust in a free enterprise economy. Is the central purpose of antitrust to promote a decentralised decision-making mechanism, or is it simply to promote a maximum of 'consumer welfare'? Does concentration of power in the hands of a single firm or a few firms matter, or can we rely on the market to erode monopoly and oligopoly power? How should economic power be measured in the relevant product market and geographic market? If so, how can it be measured, and how should the divergence be resolved?" (Adams and Brock, p. xi.)

and Fuller recognized that the discipline of law necessarily incorporated some normative values: consistency, treating cases alike and fair notice."[109] We address the problem of discretion and whether antitrust theory can result in predictable and consistent legal rules more extensively in the next chapter.[110]

Meanwhile, it may be important to conclude this section by highlighting how antitrust regulations are viewed under conventional appraisal. Regardless of the particular social welfare goal sought, they all share a common thread, namely, that they are all regarded as mere instruments devoid of a particular normative content of their own.

The instrumental nature of antitrust provisions relies on the fact that the authority in question assumed to command full knowledge of the social system and social welfare standards (social values) that should be implemented with these instruments. In other words, this view of regulation not only assumes the omniscience of the authority in connection with the underlying social activity, but also assumes that all the information necessary for choosing the "right" welfare standard is "there".

Furthermore, no matter what the particular public interest goals they are based on, antitrust regulations assume that real markets are placed at a sub-optimal state; consequently, they assume their purpose is to push reality towards the optimum, whatever that optimum means. For this reason, "the base line norm (to judge a business conduct) is not the state of affairs before any contract (which is always imperfect), but *the achievable state of affairs under the competitive equilibrium that is the social optimum*". (Author's italics)[111]

Antitrust regulations should be implemented at any instance in which there is deemed to be the existence of a failure in the system created by a firm attempting to reap "monopolistic" profits accrued from exploiting an information asymmetry in a given

109 Katz, "Positivism ..." at 2239.

110 See Chapter 3, section 2, below.

111 Epstein, Bargaining...., p. 54.

market, which is not justified as a "efficiency". This does not mean that antitrust regulations are exclusively addressed to attaining "efficiency" in the social system; it simply means that efficiency is always a base-line norm from which other welfare standards (if any) are introduced in the appraisal of the authority to measure whether public goals have been achieved. In other words, it is practical enforcement, as expressed in the combination of these welfare standards, which ultimately guides the normative appraisal of policy enforcement.

Briefly, they attempt to achieve a social welfare formula that represents some measure of aggregate welfare carrying interpersonal comparisons of individual utilities. These comparisons are made through a "rule of reason' analysis in which the social costs and benefits of a given undertaking are contrasted to determine whether social welfare has been achieved. How this balance should be struck is something that is not solved under the rule of reason analysis. In fact, given the assumption of the observer's objective knowledge, and the conflation of positive and normative that he is subject to as a result of formalism, it is not surprising that the aggregation of individual preferences into a social welfare formula inevitably leads to confuse the preferences of the observed individuals with those of whoever is making the calculation. Consequently, under this perspective "Public Interest" does not necessarily represent the interests of the public.[112] In the next chapter we will address these problems more extensively.

Let us now see how this vision of the regulatory process meddled with the culture and traditions that pervade policy-making in Latin America.

1.2.- Emergence of the conventional paradigm of regulation in the Latin American experience.

The instrumentalist appraisal of legal formalism has been embedded in Latin America's legal culture long before *apertura* began. The intellectual influence of logical

112 Rawls explicitly makes this point in his criticism of utilitarianism. See. J. Rawls. A Theory of Justice. (Oxford: Oxford University Press. 1971). pp. 22-27.

positivism was very germane with the region's Hispanic tradition, which in the end was the driving force of interventionist policy-making in the region. De la Vega highlights the significance of this influence: "Positivism has been acknowledged as a stream of thought that most forcefully induced a break with the traditional status quo, and hereby it seemed to favour a new social ordering, mainly during the period between the last quarter of the nineteenth century and the first quarter in the present century. This period has been, moreover, crucial for the course thereafter adopted by the majority of Latin American countries, and the clue to understand the present situation of our countries. [Indeed] the general features of such historical processes would favour or inhibit certain forms of economic and social development. They would stop or foster certain economic and social policies; certain ways of economic and cultural production. They would overvalue certain intellectual or aesthetic systems to the disadvantage of others; to invalidate or ratify certain ways of social dynamics. Thus, cultural patterns and ideological models adopted in the political setting and materialisation of the different (economic and social) projects favoured the imposition of certain economic and social choices, to the detriment of others, and helped to legitimise them."113

A look back at the history of Latin America shows that the roots of the aversion towards free markets, found in the strong political and economic centralism practised in the region, extends back to colonial times. For example, a brief look at the colonial period indicates that the strong presence of the Spanish and Portuguese Crowns in the economic affairs of the colonial settlers discouraged private productive endeavours. Veliz contends that the colonisation failed to encourage the emergence of property rights, regarded as "immunities" gained from the power of the Crown. Instead, Latin America followed the dictates of the growing colonial bureaucracy that dominated economic life.114

113 De la Vega, pp. 39-40.

114 Veliz, The Centralist Tradition ..., The presence of the Crown was most evident in the numerous conditions imposed on the recognition of private property rights over the land and resources discovered by the Spanish and Portuguese settlers in the New World, as well as on the imposition of heavy taxes by the Crown. The literature on the economic history of colonial Latin America is vast and cannot be addressed here fully; however, for a general appraisal see, J. Crow, The Epic of Latin America, (New York: Doubleday & Co., Inc., 1946), pp. 154-164, 178-191; and G. Céspedes del Castillo, América Hispánica (1492-1898), (Barcelona: Editorial Labor, S.A., 1986), pp. 121-140; 255-274.

The formal sense and understanding of the law, individual rights and legislation which has prevailed in the culture of the region since its inception is greatly responsible for this. The attitude is well summed up in the phrase *"Obedezco pero no cumplo"* (I obey the law, but do not comply with it), which characterised the attitude of the *Conquistadores* throughout the colonial period before the Crown: that is, an ambiguous disregard for law enforcement, given that the law did not reflect the underlying realities of trade.115

Current legislation reflecting this legal positivism has expressed itself through the prevailing legal culture in the region: whilst the law has been viewed as a tool with which to implement social justice through government fiat, in reality formal mechanisms are extensively divorced from the rules effectively followed by these societies. This is a perception which was inherited from the notion of law held by Spanish legal scholars at the time of the colonisation of the New World. As Moreno explains: "From its very beginning written Spanish law was far more an expression of ideals to be attained than a reflection of social customs and traditions... As the Etymologies of St. Isidore ...show, the strength of ancient local habits was undermined by a legal system that claimed moral superiority. Law could only be understood in terms of justice... What the ...Spaniards did was to establish the direct priority of justice over law. Specific legislation could be superseded on the basis of ... abstract moral conceptions..."116

115 De Madariaga summarises why this contempt for the law is embedded at the heart of Latin American economic institutions: "[In the process of colonization] there were certain forces and circumstances that made a powerful contribution to the economic and commercial life of Latin America, (...) First, the lack of knowledge of economic facts which prevailed then everywhere (...) second, the natural vitality of the region, which permitted considerable wealth; third, *the universal habit of evading the law*, which eventually led to a black market that made it easier to trade outside the law than within; fourth, *the philosophical contempt with which viceroys received and disregarded Royal Orders they regarded as inapplicable.* (...) Finally, the fifth element shaping the economic life of Latin America was the fact that commercial considerations at the level of the Spanish Crown were subject to political and religious criteria, due to a faith and a philosophy which invaded all aspects of life at the time" (S. De Madariaga, El Auge y el Ocaso del Imperio Español en América, [Madrid: Espasa-Calpe, 1986], pp. 140-141)

116 F. Moreno, Justice and Law in Latin America: A Cuban example, 12 Journal Inter-American Studies and World Afairs [1970]: 367, 374. See also, F. Moreno, Legitimacy and Stability in Latin America: A Study of Chilean Political Culture (1969) 6-11.

The "status quo" which has prevailed since the very inception of Latin American institutions has always diminished economic rights which have often been surrendered before successive "public interest" goals, as interpreted under successive governments.117 These origins, which provided the seeds for the institutions which prevail in the region, ultimately explain government intervention and the attitudes of policy-makers to markets across the region.

In the course of time, Latin American institutions have merely re-enacted successive forms of centralism and legal formalism thus forestalling private entrepreneurship at the expense of growing bureaucracies. Rather than providing an institutional setting favourable to the development of market institutions, the political independence of Latin American republics perpetuated the centralism of colonial times. Political independence soon turned into a state of constant political instability in the independent republics during the nineteenth century; a process which favoured *de facto* seizures of property amidst of constant civil wars.118

These factors acted against the growth of free markets, and resulted in the socio-political ideologies that brought representative democracies into the region during the

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117 This is a common trait of all Latin American constitutions, which allow "public interest" to limit economic rights. (L. Ortiz and J. Lejarza, Constituciones Latinoamericanas, Biblioteca de la Academia de Ciencias Políticas y Sociales, Caracas, 1997.) There is a noteworthy similarity between the economic policies of dictatorships and democracies in the economic history of the region. This is not often emphasised by historians of the region, who tend to make a political appraisal of recent history, which has overshadowed important economic subtleties. Generally, these historians perceive dictatorships as allies of foreign economic interests. In contrast, they regard democracies as committed supporters of autonomous development. However, a closer appraisal shows that both types of regimes have systematically practised strong government interventionism, eclipsing private investment in favour of "public goals." As Veliz rightly observes: "During the decades following the Great Depression and the Second World War, decision centres governing Latin American economies were not controlled by the private sector, but by the public sector. This has nothing to do, or at least very little, with the position that political parties hold within the classic spectrum: the governments of Cuba and Mexico, of Chile and Peru, of Brazil and Argentina are centralist not because they are left-wing or right-wing, capitalists or socialists, but because they are Latin American." (Veliz, p. 233). Stable institutions provided by democratic regimes were frequently regarded as inconvenient, slow, rigid and paralysing mechanisms for active and dynamic governments. Dictatorships were frequently praised for their apparent speed in solving economic problems and capacity for dealing with pressing problems of poverty in the region.

118 Veliz, pp. 118-161.

twentieth century.[119] In this century, political unrest has evolved into more stable democratic institutions, through the consolidation of popular mass movements. These changes, however, have not changed the status quo regarding the protection of property rights, as the movements were taken over by a mix of a indigenous social-democratic and socialist ideology (influenced by the Mexican Revolution of 1910 and the Russian Revolution of 1917) which generally made the exercise of property rights conditional to a 'social function'. Consequently, the agenda of the Social Democrat political parties that emerged out of these mass movements called, in most cases, for the implementation of nationalist economic policies structured on economic guilds, demanding nationalisation or extensive state ownership of the basic resources of their countries.[120]

Additionally, the influence of the Catholic Church over political and economic ideas in the region has been significant. The active presence of Christian Democrat parties in many countries is evidence of this. Although initially inspired by a conservative reaction against left-wing Social-Democrat and Socialist movements, Christian Democrat parties endorsed an anti-capitalist ethos. More recently, the reaction of the Church against the inequalities created by reform programmes has extended beyond the realm of its related political movements. In some contexts, the manifestations of Catholic thinking have become less subtle (acquiring a clearer anti-capitalist bias) in new forms of expression such as the influential "Liberation Theology", which preaches a new "salvation of the soul" through the redistribution of social wealth. In the words of Fessard, "Marxist Christianism and Liberation Theology are [like] two relatively independent rivers.

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119 See in particular, C. Rangel, The Latin Americans, their love-hate relationship with the United States, (New York: Harcourt Brace Jovanovich, 1977). In this study, Rangel challenges the mainstream view that Latin America's poverty is somehow related to the promotion of Western institutions in the region, such as representative democracies, political tolerance and the protection of individual rights. He evaluates how the governing elite in these countries have consistently blamed alien influences in order to justify their failures in building successful models of economic development.

120 An account of the influence of social democrat parties in Latin America is found in C. Rangel, The Latin Americans..., pp. 56-61. Also, M. Niedergang, The Twenty Latin Americas, (London: Penguin Books, 1969). On Latin America's contemporary political history, see T. Halperin Donghi, Historia Contemporánea de América Latina, (Bogota: Alianza Editorial, 1969).

possessing, however, the same source, their waters frequently mixing either subtlety or in full sight, mutually reinforcing each other".[121]

The combination of these factors has created the perception amongst Latin Americans that economic development and growth has little connection with the existence of stable institutional frameworks where individuals may prosper, but with government intervention.[122] Development was a goal that adequate government rules could achieve; failure to accomplish such a goal would be a result of faulty enforcement, not the result of deficient institutional design.

Economic rights have become dependent upon such appraisal, to the point of being subjected to their express inclusion in a written statute, as a condition for their effective exercise before a court of justice.[123]

Not surprisingly, Latin American policy-makers have come to regard government rules as instruments for reinforcing economic rights and tools for the consolidation of their respective "Economic Constitutions".[124] In this context, antitrust laws are viewed

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121 See, G. Fessard, S.J., Teología de la Liberación: Génesis y Trayectoria, (Caracas: Universidad Católica Andrés Bello, 1979), p. 5.

122 Several historical factors combined to develop a centralist culture in the region that reinforced anti-capitalism. As Véliz explains: "Latin American society presents some traits, which in other regions, above all in the countries of the cultural area of north-western Europe, are inseparable from the consequences of the Industrial Revolution, but here possess an origin and character undeniably preindustrial. It is a bureaucratic tradition of preindustrial rationalization on which centralism relies that shaped the processes of change and continuity and an urban preindustrial culture sui generis within which a vast service sector has evolved, closely related to the bureaucratic habits and institutions". (Véliz, p. 16.) To justify these views some intellectuals hold that the region's problems are unique and as such, demand special theories and ad-hoc solutions. Others insist on blaming external forces. Borner et al. also contend in the same sense: "this intellectual bias against markets led to the development of some interesting, yet at the same time dangerous, intellectual perceptions about Latin American development process that have resulted from this situation". (Borner et al., p. 9.) A general exposition of this view is found in Rangel, The Latin Americans...

123 García de Enterría, La Lengua..., pp. 114-152.

124 For example, Tineo regards these laws as improvements over the traditional set of rules governing market relations: "The old generation of laws refers to those enacted prior to the launching of the economic reform processes under way since the mid-1980s. These laws emphasised the prosecution and punishment of anti-competitive practices, some of the practices being considered criminal offences. Institutionally the competition agencies lacked

as setting reasonable restraints on economic rights, a condition that is indispensable if young and weak Latin markets are to function adequately. Indeed, the recently liberalised Latin markets will not develop if "fair" rules of conduct governing their functioning are not established to prevent abuses.

Ideology and history in Latin America have converged in the consolidation of a regulatory appraisal throughout the region that regards market phenomena as reality, which purposive policy-making could bend according to "developmental goals". Unquestionably, this explains why antitrust policy has been welcomed without much consideration by legal scholars and policy-makers in the region. Indeed, the closed-end view of markets, instilled by the conventional paradigm, was highly compatible with the way policy-making had been understood and implemented in the region long before the outset of institutional economic reform in the 1980s.

Having examined the intellectual sources of antitrust in Latin America, and their particular appraisal of market functioning, let us now take a closer look at the way policy-makers reach their particular normative conclusions about corporate structures and business strategies.

2.- MAIN FEATURES OF ANTITRUST ENFORCEMENT IN LATIN AMERICA.

2.1.- Taxonomy of anti-competitive practices under antitrust enforcement in Latin America.

The closed-end view of markets, which makes the existence of competition conditional upon the multiplicity of market participants, inevitably led antitrust scholars to presume the monopolistic intentions of any business initiative would reduce or curb market entry to potential participants or compromise their decision-making independence.

independence and since most practices were illegal, the enforcement decision was subject to changes, delays or simply not executed by the Ministry of Commerce in the last instance. [As a result] these countries have recently introduced amendments to make enforcement of such laws more effective". (Tineo, Competition Policy..., p. 10.)

The basic idea that competition was somehow dependent on the degree of market concentration was very powerful, particularly in the examination of competition in less developed countries. In these underdeveloped markets, the conditions of concentration seemed to be even more evident.

Following the rationale of the SCP paradigm, several legal doctrines were developed as extensions of the basic idea that market structure and economic performance are somehow related. These doctrines are: Firstly, the "doctrine of dominance", according to which the larger the concentration of markets, the more likely dominant firms are to impose exploitative prices or conditions upon consumers. Secondly, the "doctrine of collusion" or oligopolistic behaviour, which states that the fewer competitors there are in the market, the more likely they are to collude to eliminate competition and behave as dominant firms are presumed to do. Thirdly, the "doctrine of exclusion of competitors", according to which firms possessing market power may engage in certain conducts and arrangements to impose exclusive arrangements and preferential conditions in order to exclude competitors from the market. This doctrine, also called the "potential competition theory" has been extensively enforced in Latin America.[125] Finally, the "doctrine of predation", whereby dominant firms may displace competitive firms from the market by artificially undermining prices or distorting markets.[126]

Antitrust schemes are not uniform in their legal treatment towards corporate structures. They lack a uniform criteria for the types of conducts that constitute monopolistic behaviour. Indeed, Latin American antitrust statutes frequently contain

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125 As Singham observes, Brazil's CADE has been particularly active in enforcing this doctrine in the analysis of mergers and long-term exclusive dealings. (S. Singham, Shaping Competition Policy in the Americas: Scope for Transatlantic Co-operation? 24 Brooklyn Journal of International Law, (1998) pp. 380-382.)

126 Alternatively, Bork classifies these doctrines as follows: a) The doctrine of the "agreed elimination of rivalry"; b) The doctrine of "automatic exclusion of competition" and c) The doctrine of predation". (Bork, pp. 135-160.) Posner, on the other hand, distinguishes between practices that facilitate collusive pricing; exclusionary practices and practices that are monopolistic since they increase the gains from monopolistic pricing, but are not collusive nor exclusionary. (R. Posner, Antitrust Law, (Chicago: The University of Chicago Press, 1976), pp. 23-35)

extensive lists of restrictive types of conduct or economic organisation which tend to be anti-competitive, but the lists change according to the jurisdiction. In a way, this is a consequence of the international debate about which corporate forms should be considered likely to promote anti-competitive behaviour. Although most Latin American antitrust statutes provide for an omnibus prohibition or general clause against all business practices that curtail, limit, restrict or distort competition, they differ in the structure they attach to legal prohibitions.

Some statutes make a distinction between absolute and relative prohibitions; no doubt inspired by the differentiation made under U.S. antitrust law between conduct *per se* and conduct subject to a rule-of-reason analysis. *Absolute* prohibitions are undertakings regarded as void, whereas *relative* prohibitions require the relevant firms to wield substantial power in the relevant market. This distinction is made in the Mexican, in Costa Rican and Panamanian legislation.[127] Other schemes such as Venezuela's, do not acknowledge such a distinction, but simply combine an general provision with a list of forbidden conduct.[128] In general, as Tineo argues, legal structure "is affected by the type of enforcement power which the law and case law developed in each country confer on the competition agency".[129] However, it is possible to draw certain commonalties.

These common features follow the inferences drawn from these legal doctrines on the effects of market concentration on the anti-competitive behaviour of firms. On the basis of these it is possible to develop a "taxonomy" of anti-competitive practices in Latin America's antitrust schemes. These practices are based on a formal distinction between unilateral and multilateral anti-competitive undertakings. In turn, multilateral restrictions on competition are classified according to whether the conduct occurs between competitors (horizontal restraints) or non-competitors (vertical restraints).

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127 Singham, p. 391.

128 Id.

129 Tineo, Competition..., p. 11.

a) <u>Exploitative practices: output restriction and other conducts</u>.

Antitrust policy seeks to eradicate output restrictions, whether agreed collectively or unilaterally imposed. The prohibition of agreements amongst firms restricts competition aims to preserve the "independence" of market participants actions, which drives prices as close as possible to marginal costs. Therefore, any attempt to restrict output by means of combination, agreement or similar arrangement should be discouraged by heavy penalties.

The definition of "exploitative" conducts under antitrust domestic rules is very broad. Generally, the list of these practices comprises the following conducts:

a) abusive pricing by a monopolistic firm;
b) resale price maintenance;
c) co-ordination amongst competitors to impose monopolistic prices.

In turn, horizontal co-ordination may also adopt several forms:

a) naked output restriction;
b) price fixing;
c) co-ordination of the conditions of sale;
d) bid rigging;
e) customer allocation, and
f) price discrimination through market segmentation;

Naked output restriction is regarded as anti-competitive because neo-classical economic theory assumes that it is done with the intention to impose monopolistic (i.e. exploitative) prices. It often results from so-called collusion and other horizontal restraints aimed at fixing prices at supra-competitive levels. For this reason these arrangements are perhaps "the core area of concern in existing competition laws", in the opinion of Khemani and Dutz.130 Their negative effects are immediately presumed to be there due to the inexistence of any collateral efficiencies that would otherwise justify them. The general consensus about the anti-competitive nature of these agreements, is that they eliminate rivalry amongst competing suppliers; hence, these corporate structures have "the greatest need for penalties".131

By contrast, other horizontal restraints may be more ambiguous in their effects, since they normally combine forms of co-operation regarded as beneficial. Examples of these are joint ventures, research and development agreements, and exchange of information.

All Latin American antitrust statutes reviewed have provisions for dealing with horizontal agreements that restrict competition, such as price fixing, bid rigging, market segmentation, customer allocation and other forms of output restraint. Generally, this kind of conduct is regarded as per se prohibited.132

Output restrictions in the form of price fixing have been a focus of concern for nascent Latin American antitrust agencies. The reason generally advanced to challenge them has to do with the reluctance of businesses to compete, allegedly resulting from the persistence of prior interventionist policies in the business culture of Latin American entrepreneurs. This type of conduct, which governments in the region actively promoted in the past though regulations and official prices, has frequently endured beyond

130 Khemani and Dutz, p. 21. Similarly, Boner argues: "reforming economies are often advised to give high priority to the prosecution of price fixing" (R. Boner, "Competition Policy and Institutions in Reforming Economies" in Regulatory Policies and Reform: a Comparative Perspective, Private Sector Development Department, (Washington, DC: The World Bank, 1995), p. 42)

131 Khemani and Dutz, p. 21.

132 For example, in Brazil any limitation or restriction of competition among competitors, regardless of the intention involved, is regarded as wrong. Among these conducts are: fixing conditions of sale, boycotts against new entrants, obstructing access by competitors to resources or technology, as well as exclusion from the media. (See "New antitrust legislation is signed by President of Brazil", Antitrust and Trade Regulation Report, 30 June 1994.)

apertura; hence, the significance of this sort of restriction in the enforcement endeavours of Latin American antitrust agencies.[133]

The prosecution of tacit collusion may prove difficult, due to constraints on gathering evidence. For this reason, much attention has been devoted to analysing the behaviour of industry and trade associations in their collection of information, reciprocal checking of price quotations, reduction of secrecy and facilitation of collusion.[134] In other cases, significant nominal price changes, due to government controls and high inflation rates, make enforcement difficult;[135] this probably counts as an additional reason for the conspicuous emphasis of Latin American antitrust enforcement on merger control, as we shall see below.

As elsewhere, some Latin American jurisdictions exempt certain cartels from antitrust enforcement, albeit inspired on political rather than economic considerations: for example, export cartels. Other combinations, such as "depression" cartels focused on the rationalisation, specialisation, development and standardisation of goods and services are justified on the basis of obtaining advantages that would otherwise be unattainable, such

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133 For example, in Peru cases have been brought against petrol pump suppliers and stations, public transportation and bread. See, C. Guzman-Barron, Experiencia Peruana en el Sistema de Libre Competencia, paper presented at the first meeting of Latin American competition agencies, Cartagena, Dec. 1995, pp. 2-3.

134 Venezuelan antitrust enforcement has been particularly active in reviewing the links of firms investigated for price fixing and relating them to their membership of a given trade or industrial association, as for example in the cases C.A. AGA Venezolana y Gases Industriales de Venezuela C.A. (1992) (liquid oxygen); Premezclados Avila (ready-mixed concrete) (1993); AVAVIT (Association of tourist agencies) (1994); Camara Venezolana de la Industria del Cine y del Video (1994). (See Informe Anual, Superintendencia Pro-Competencia, Caracas). Similarly, in the Brazilian services sector, Salgado highlights the influence of labour unions and associations in fostering cartel behaviour through similar contacts among their members: "No setor de servicos, a prática mais comum é a cartelizacao, elemento já evidenciado com a forte presenca de associacoes e sindicatos como agentes representados em processos. Eis aí uma informacao importante para orientar o acompanhamento deses segmentos que, *muitas vezes nao concentrados, sao organizados por associacoes que difundem informacoes e padronizam comportamentos*". (Author's italics) (L. H. Salgado Política de Concorrência: Tendências Recentes e O Estado da Arte no Brasil, IPEA/DIPES, Texto para Discussao No. 385, (Brasilia: Instituto de Pesquisa Econômica Aplicada, 1995), p. 29) In general, see Jatar, Competition Policy in Latin America, pp. 11-14, and Tineo, Competition..., p. 25.

135 Khemani and Dutz, pp. 21-22.

as economies of scale, sharing risk and information.[136] These arrangements are allowed as long as they do not involve output restriction.

b) Exclusionary practices: monopolisation and vertically restrictive arrangements.

Antitrust also seeks to increase (or preserve) the number of participants in the market. The more participants in the market, the wider the array of choices available for the benefit of consumers. The SCP paradigm leads the analyst to assume that competition will be more intense in markets comprised by more interacting firms, since in such cases the former will be closer to perfect competition, which represents the ideal normative standard. In this regard, antitrust policy focuses on ensuring that market structure promotes the existence of more independent outlets. This is the rationale for condemning individual or collective endeavours that inhibit or preclude the ability of other existing or potential suppliers to compete in the market for a product, for example *exclusionary practices*.

Automatic exclusions may be individually or collectively exercised. In either case one or more suppliers take actions that hinder the entry of potential competitors. Examples of individual exclusionary conducts are the following:

a) refusal to supply.
b) discriminatory pricing.
c) abuse of patent rights.

Refusal to supply involves the case where suppliers refuse to deal with specific clients for no other apparent reason than to impose higher prices or onerous conditions on them, or to exclude them from a downstream market where they compete with the

136 Id., p. 22. For example, Article 49 of Colombian Decree 2153, 1992 exempt certain restrictive agreements based on standardisation of rules, research and development and use of common facilities. Similarly, Article 18 of Venezuela's Ley Pro-Competencia, and Article 16 of Regulation No. 1, allows agreements aimed at increasing output, improving the distribution and trade in goods and services, development of common rules, agreements for export of goods; and franchising agreements.

services/products delivered by the suppliers' integrated firm. Further, through discriminatory pricing suppliers will charge different prices to different customers for orders placed under similar circumstances for no apparent reason. This conduct has been regarded as anti-competitive since suppliers can discriminate if they are able to restrict their output according to the customer. In other words, discrimination has been construed as a clear sign that the supplier is restricting his output to a particular customer. Finally, a firm may use its patent rights to exclude a competitor.

On the other hand, collective action to exclude competitors may be be imposed by competitors (boycotts) or through vertical restraints between non-competitors. Vertical restraints comprise agreements between suppliers and purchasers in separate upstream and downstream markets. Khemani and Dutz provide a complete list of these contractual forms, insofar as they are relevant for antitrust purposes:

a) restrictions on pricing (for example, resale price maintenance, setting a final downstream price);

b) restrictions on market partner choice (exclusive dealings), when the buyer is induced to deal only with one seller's products;

c) refusal to deal or supply, when buyers encounter difficulties in obtaining products from suppliers, usually aimed at coercing them into adopting an anti-competitive practice);

d) restrictions on choice of location (exclusive territory arrangements), when the geographical territory in which the buyer may resell is limited;

e) restrictions on purchase choice (tying), when the availability of one product is contingent upon the purchase of other goods or services, and full-line forcing, which is a form of tying where the manufacturer requires the distributor to carry all its products; and finally,

f) restrictions on other business practices (such as trade-names, brand logos, store set up, and form and content of advertising, as in franchising agreements).[137]

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137 Khemani and Dutz, p. 22.

Exclusive dealings prevents other potential distributors/suppliers from competing in the market for the product concerned. These arrangements have been considered as monopolistic if in force for long periods.[138] They may also be coupled with additional efficiencies or a provision for some other social good. In this context, franchises are not seen as openly anti-competitive devices, perhaps because they are seen as tools of foreign investment. Indeed, this fact has led many jurisdictions in the region to allow these business arrangements. Finally, territorial restraints are sometimes agreed to prevent one of the parties from selling in one particular market. Antitrust theory creates the suspicion that these restraints are attempts to disguise other monopolistic practices, such as discriminatory pricing.[139]

Compared with collusion, Latin American policy tends to regard vertical integration and restraints imposed upon suppliers or would-be clients with more benevolence.[140] Under a conventional perspective, these agreements are permissible, provided they "promote economic efficiency by overcoming market failures".[141] On the one hand, the agreements prompt antitrust concerns because they may enhance or consolidate the market power of major participants by facilitating collusion amongst established firms in upstream or downstream markets or by encouraging market foreclosure, that is, the elimination of incumbent or new competitors from the market.[142] This is particularly important in Latin American countries, as Curiel argues, since in such comparatively small economies, they could easily result in entry barriers to more competitors who are already scarce.[143]

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138 T. Burke, A. Genn-Bash and B. Haines, Competition in Theory and Practice, (London: Routledge, 1988), pp. 162-166.

139 Boner and Krueger, p. 56.

140 Several antitrust statutes regard vertical restraints as "relative" prohibitions subject to a rule-of-reason analysis. For example, Mexico (Article 10 Ley Federal de Competencia Economica); Costa Rica (Article 12 Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor, 1994); Panama (Article 14 Ley No. 29, 1996); Venezuela (Article 4, Regulation No. 1).

141 Khemani and Dutz, pp. 22-23.

142 Id., p. 23.

143 C. Curiel, Diseño de un Modelo de Abogacía de la Competencia en el Contexto de la

On the other hand, however, they frequently result in efficiencies which also deserve consideration. Their restraints "overcome a market failure whenever they internalise externalities that arise when downstream enterprises ignore the effect of their actions on upstream profits".144 Economists generally emphasise efficiencies such as improving the supply of retail service and quality to consumers; hence, the conventional view considers these problems as resulting from misplaced incentives that could endanger "efficient" resource allocation, since they discourage parties from undertaking certain investments. For these reasons, mainstream scholars adopt a rule-of-reason against this type of conduct, and warn developing countries against adopting stringent rules in this field.145

In Latin America, the enforcement experience on these arrangements has been uneven, despite the structural similarities of domestic economies in the region. Perhaps the reason for this phenomenon is found in the slow, convergent learning process of national antitrust agencies dealing with these restrictions. Latin American antitrust agencies are still very inclined to follow their own policy agenda, which is shaped by theoretical as well as practical considerations: the difficulties of preparing a case against a firm often counts as much as any other consideration.146

Implantación de las Políticas de Competencia en Latinoamérica, paper presented at the Restrictive Business Practices Unit at the UNCTAD Secretariat, Procompetencia, 1996, p. 15.

144 Id.

145 Id., p. 24. In this sense, Jatar also observes: "the prohibited conducts should establish clear differences between agreements among competitors who are trying to restrict competition and vertical restraints, which are usually made for efficient reasons (...) [this policy] permits competition policy-makers to concentrate their efforts on clear cases of cartelized behaviour and avoid decisions over cases where the anti-competitive effects are difficult to evaluate." (Jatar, Competition Policy in Latin America, p. 21.)

146 However, uneven enforcement does not mean that it is non-existent. Chile, for example, has an intense tradition of controlling vertical restraints, rather than the prosecution of cartels. Between 1974 and 1992, the number of vertical cases prosecuted by the Chilean Resolutive Commission (Chilean antitrust body) was 117 (61 cases on vertical agreements; 156 cases on vertical restraints), compared to 61 horizontal prosecutions. (Paredes, Políticas de Competencia en un País sin tradición de Mercado (Chile), p. 17). Other Latin American countries, such as Argentina and Venezuela, have had a more moderate experience in this field.

More frequently, vertical agreements are seen as monopolising behaviour, in the context of "market dominance". Sometimes this standard takes on a separate identity from other vertical restraint prohibitions.[147] In other cases, however, it has been regarded as an additional form of vertical restraint; as in Argentina, Chile, Costa Rica, and Brazil.[148] Faced with severe difficulties in obtaining evidence of the restrictive nature of vertical agreements, Boner argues that incorporating an abuse of dominant position doctrine is highly desirable, because "treating vertical restraints as an abuse of dominance requires a complainant to establish that the firm imposing the restraints is dominant. This standard has some notable advantages for the reforming economy: vertical restraints are prohibited for large, dominant suppliers but are legal for other suppliers. Thus, the restraints are legal where they are most likely to be technically or allocatively efficient".[149]

c) Mergers and acquisitions.

This area of antitrust policy is the most controversial and perhaps the most frequently used by Latin American antitrust agencies in their enforcement work.

Antitrust agencies regulate economic concentration because this is interpreted as a sign companies' intentions to acquire a dominant position aimed at seeking monopoly rents, as it establishes the platform for abuse of a dominant position. Following a structural view of markets, mergers and acquisitions can only be seen as reducing the number of "independent" traders in the market concerned. Boner argues: "merger control and other structural regulations are designed to preserve the independence of suppliers and to prevent corporate transactions that would substantially eliminate competition".[150]

147 In Venezuela, the law prohibits "the abuse on the part of one or several persons subject to this law who hold a dominant position in all or part of the national market..". (Article 13 Ley Pro-Competencia). At regional level, the Andean Group (Venezuela, Colombia, Ecuador and Bolivia) prohibits abuse of a dominant position. (Articles 3 and 5, Decision 285 of the Andean Community).

148 See, Paredes, Políticas..., p. 17; in general, see OAS, Inventory...

149 Boner, Competition Policy and Institutions in Reforming Economies, at 44

150 Id. In general, see Boner and Krueger, Op. Cit., pp. 68-84.

These structural regulations complement the "gaps" in "conduct" prohibitions, whose absence, in Boner's opinion, would induce monopolists to devise mergers as corporate strategies to elude cartel prohibition: "[in the absence of] structural regulation, mergers would allow competing suppliers to co-ordinate pricing policies; this conduct would otherwise be illegal".[151]

Khemani and Dutz also refer to the potential negative effects of mergers. In their opinion, horizontal mergers amongst two or more firms in the same line of business reduce the number of competing firms and increase market concentration; vertical mergers amongst firms engaged in different stages of production may close sources of inputs or distribution channels to competitors; and conglomerate mergers among firms in diversified or unrelated businesses may lead to cross-subsidisation and reciprocal arrangements that limit competition.[152]

Perhaps these reasons explain why policy enforcement in this field has been particularly active in some Latin American countries. The investigation of mergers' effects on competition is subject to similar guidelines to those used in the United States. These guidelines include:

a) The value of the transaction and of the assets involved;

b) the identification of both the product and geographic relevant market;

c) the dynamics of competition, in terms of number of competitors, production capacity and product demand, regulatory constraints, and the like;

d) entry barriers;

e) concentration levels, as measured under the Herfindhal-Hirschman standard;

f) efficiencies accruing from the concentration, and eventually,

g) whether the merging firms would go bankrupt if the merger doesn't take place.

151 Boner, p. 44.

152 Khemani and Dutz, p. 25.

It is interesting to note that wherever merger control has been incorporated into national legislation, it has become the preferred tool of enforcement by antitrust agencies. For example, Mexico's *Comisión* has devoted the bulk of its resources to evaluating mergers and acquisitions. Rowat argues: "The bulk of the [Mexican antitrust] Commission's activity has been devoted to merger cases based partly on the fact that the pre-notification requirement provides an effective way of generating cases".153 Venezuela has taken a more balanced approach to its enforcement policy; nevertheless, mergers are an important part of its work, even though per-merger notification in this country is not mandatory.154 Brazil and Colombia also possess significant merger enforcement systems.155 The reasons invoked for active enforcement in this field vary. Merger enforcement has been negligible only in countries where antitrust is very recent, such as Costa Rica and Panama.

Other countries, however, have preferred other alternatives to merger regulations. The laws of Argentina, Chile and Peru do not contain express provisions in this area. In these countries, concentrations are only prosecuted, if they create a dominant position in the market. In this case, the undertaking is treated as abuse of a dominant position. Other countries, such as Costa Rica and Panama, possess provisions, are too vague to allow any

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153 Rowat, p. 16. In 1993-1994, the Mexican *Comisión* received 52 notifications and decided 45. By contrast, it opened 22 investigations for monopolistic conduct. In 1994-1995 there were 109 notifications, an increase of 27% from the preceding year, compared to 17 cases of restrictive practices. (Comisión Federal de la Competencia, Informe Anual 1993-1994, Mexico, D. F., 1994.; also, Informe Anual 1994-1995, Mexico, D. F., 1995.)

154 During 1993, Venezuela's Superintendencia Pro-Competencia authorised 5 merger proposals out of 6, while it examined 13 cases involving restrictive conducts; in 1994 it decided 7 merger cases and 7 cases on restrictive undertakings; in 1995, it decided 10 merger cases compared to 9 prosecutions on restrictive conducts. (Superintendencia Pro-Competencia, Informe Anual 1992-1993, Caracas, 1993; Informe Anual 1994, Caracas, 1994; Informe Anual 1995, Caracas, 1995.)

155 According to Mattos, "CADE has focused its work, since 1994, more on mergers than on anti-competitive conducts, which is not consistent with the international trend. (...) This can be seen by the low level of anti-competitive conducts judged relative to the stock of such cases at CADE in 1996, 23% compared to the same statistics for mergers which reached 59%". (C. Mattos, The Recent Evolution of Competition Policy in Brazil: An Incomplete Transition, paper presented at the conference on Competition Policy and Economic Reform, Rio de Janeiro, Brazil, 10-13 July 1997, p. 6.)

enforcement.[156] The reasons for not actively enforcing merger control in these countries vary, but an important factor seems to be the lack of technical skills for developing elaborate regulatory standards and techniques which differentiate between "good" and "bad" undertakings. This is particularly true in the determination of market power and the evaluation of efficiencies.[157]

2.2.- The relation between market concentration and economic efficiency in the design of legal prohibitions under Latin American antitrust enforcement.

The fear of large firms is an ever-present issue amongst antitrust scholars when analysing competition in Latin America, and more broadly, in developing countries. Jatar argues that the high market concentrations common in the region have "important implications for antitrust enforcement".[158] These implications refer to the increased likelihood of cartel formation, and to their gaining market power after the liberalisation of prices. For Khemani and Dutz, "many of the analytical problems posed by a small number of market participants and oligopolistic interdependence are more likely to occur in small economies than in larger ones".[159]

These concerns are mirrored in the antitrust legislation of most Latin American jurisdictions. These statutes lend paramount importance to market concentration in ascertaining the existence of anti-competitive acts. Some statutes set specific concentration levels, beyond which any undertaking deemed to be restrictive by participants is regarded as a legal breach. For example, Article 20 of Brazil's Lei No.

156 Tineo, at 20. In our opinion, Tineo's conclusions are not entirely warranted. Article 16 of Costa Rica's *Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor* (1994) regards concentration activities as relative prohibitions, and subjects them to ex-post rule-of-reason analysis. On the other hand, Article 20 of Panama's *Ley No. 26, 1996* allows managers to request authorization to undertake a merger operation, at their discretion; but no effects occur if a merger is refused. However, mergers without authorization could be legally challenged within the first three years. (Article 22).

157 Khemani and Dutz, pp. 25-26.

158 Jatar, Competition Policy in Latin-America, p. 6.

159 Khemani and Dutz, p. 25.

8884, 1994 condemns any restrictive undertaking by firms possessing 20% of the market as anti-competitive "irrespective of their guilt".

Most statutes, however, subject the illegality of conducts involving economic concentration to the condition that they entail the undue exercise of either market power or dominance in the market. In this regard, national antitrust schemes have been intensely influenced either by European or United States competition rules.160 For example, Argentina, Peru and Colombia have incorporated the European notions of "dominance" and "abuse of a dominant position" into domestic legislation.161 Other jurisdictions rely on the concept of "market power" imported from U.S. antitrust legislation. The model of this second group is found in the Mexican *Ley Federal de Competencia Económica*, which was the first statute to adopt it.162 Some countries combine the concepts of "dominance" and "market power" in a rather confusing way. For example, Venezuela's *Ley Pro-Competencia* has a section devoted to "abuses of a dominant position"163, combined with a range of prohibitions condemning unilateral conduct which apply when a firm enjoys "market power".164 Market power is also applied to other cases in the Venezuelan jurisdiction where there is multilateral conduct leading to the elimination of "effective competition".165

In this analysis, several aspects may be considered besides the size of market share for instance, cross-elasticity of demand; distribution or transportation costs; legal rules,

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160 Practical considerations have also played an important role in shaping national antitrust schemes. For example, Latin American countries will attempt to facilitate the incorporation of foreign principles and doctrines into domestic legal systems. Mexico chose a legal antitrust structure similar to that of the United States, because of its membership to NAFTA. By contrast, other countries have adopted the European Union model, in order to facilitate the incorporation of new antitrust doctrine (because of their common civil legal systems).

161 Article 2 Argentina's Ley No. 22.262, 1980; Article 5 Peru's Decreto Legislativo No. 701, Article 45.5 Colombia's Decreto Ley No. 2153, 1992.

162 Articles 10, 11, 12 and 13, Mexican Ley Federal de la Competencia.

163 Article 13, Venezuela's Ley Pro-Competencia.

164 Articles 6-9, Venezuela's Ley Pro-Competencia.

165 Article 14, Venezuela's Ley Pro-Competencia.

and so forth. In any event, enforcement agencies hold considerable discretion in determining which elements should be used in the analysis. For instance, Article 14 of Venezuela's *Ley Pro-Competencia* assumes that market dominance in economic activity is exclusive to one person or group of related persons and whenever there is no effective competition between them. However, Articles 2 and 3 of Regulation No.1 leave the definition of both "relevant market", where competition is restrained, and "effective competition" to the Superintendency. Articles 12 and 13 of Mexico's *Ley Federal de Competencia Economica* provide a similar solution. Article 15 of Costa Rica's *Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor* instructs the *Comisión* to measure market power by following certain indicators such as the market share of the firm; the possibility of imposing prices unilaterally; the existence of entry barriers; the existence and power of competitors; access to resources and other similar considerations. Other Latin American antitrust statutes provide similar solutions.166

Antitrust laws throughout Latin America grant antitrust agencies the discretion to calculate economic performance from market concentration resulting from exploitative or exclusionary conducts, or from economic concentration. In particular, Latin American antitrust rules attach central importance to market concentration in the identification of dominance or market power; in fact, except for the relatively older antitrust statutes, this is a central consideration in all Latin American jurisdictions for judging the existence of anti-competitive behaviour.167 The discretion involved in the analysis of market power and dominance is quite significant, and extends not only to the measure of the relevant market, but also to market power or dominance's constitutive elements: degree of concentration, existence of entry barriers and the dynamics of competition.

166 For example, Article 16 of Panama's Ley No. 29, 1996 (identification of the "pertinent market") and Article 17 ("market power"). Also, Article 4 of Peru's Decreto Legislativo No. 701 and finally, Article 45 of Colombia's Decreto No. 2153, 1992.

167 The only exceptions are the *absolute prohibitions* of some Latin American jurisdictions (i.e. Mexico, Costa Rica, Panama). However, among these type of conduct, the economic assumption of anti-competitive effects expressed through the SCP paradigm is given a legal *per se* effect and therefore no further analysis is required once its existence is determined. The existence of these type of conduct does not contradict the conclusion that the concentration-performance axis determines the anti-competitive nature of market restrictions in Latin American legislation. On the contrary, it is reaffirmed.

This is perhaps most obvious in the economic analysis of economic concentrations. For example, in case No 27/94 on the proposed acquisition of Kolynos do Brasil S.A. by Colgate Palmolive Company, Brazil's *Conselho Administrativo de Defesa Econômica* (CADE) held that the merger could not proceed due to high levels of concentration in the toothpaste market. The merger was only allowed in the toothbrush sector. In Venezuela, Superintendencia Pro-Competencia challenged a proposed merger in the paint industry between Pinco Pittsburgh, S.A. and Corimón S.A.C.A. (Resolution No. SPPLC/0036-94) for similar reasons. In Mexico, the *Comisión* decided that the merger between Kimberly Clark de Mexico, S.A. and Compañía Industrial de San Cristóbal, S.A. (1995) increased the likelihood of restrictive behaviour because of its potential effects on concentration in the relevant market. Many other cases have been decided according to similar premises. In short, the concept of concentration has been pervasive in shaping antitrust enforcement in Latin American agencies.

Ultimately, the essence of the legislation relies upon economic analysis; the list of prohibitions is only effective insofar as it determines to what extent economic analysis should be applied to certain types of behaviour deemed to be more dangerous or suspicious than others. This form of economic analysis focuses on market concentration to determine whether a type of conduct or undertaking should be allowed.

In addition to market concentration, economic efficiency also plays a central role in the determination of antitrust liabilities in Latin America's schemes. This analysis is sometimes left aside as the particular conduct or economic organisation reviewed is per se presumed to entertain negative social effects. This is generally the case of price fixing, market division and bid rigging.

However, in most instances economic analysis under a rule of reason is required to evidence the underlying effects of the analysed undertakings. This analysis is applicable to vertical arrangements such as territorial restraints, exclusive distribution agreements, exclusive supply arrangements and the like. Some countries prohibit exclusive distribution to the extent that they entail anticompetitive effects. This is the case of Mexico, Panama, Brazil, Chile and Costa Rica.

Sometimes, different national statutes take differing approaches towards certain conducts not clearly within any of the previous groups. For example, tying arrangements are prohibited under a rule of reason. Refusals to deal are not included in the legislation of Chile and Mexico; other jurisdictions regard it as a rule of reason conduct. As for predatory pricing, resale price maintenance and price discrimination, there are different approaches. In Colombia and Venezuela, a dominant party can only affect predatory pricing; by contrast, in Panama it is necessary to evidence an anticompetitive purpose.

3.- Institutional arrangements for the enforcement of antitrust policy in Latin America.

3.1.- Features of antitrust enforcement in Latin America.

a) Diversity of antitrust enforcement agency structure.

Antitrust agencies in Latin America can adopt the form of administrative commissions168 or single-person superintendencies, such as in Colombia and Venezuela.169

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168 For example, Argentina's *Comisión Nacional de Defensa de la Competencia* (National Commission of Competition's Protection), has five members (Articles 6-16 Argentina's Ley No. 22.262, 1980); the Brazilian *CADE* (Administrative Board of Economic Protection), seven members (Articles 3-6 Brazil's Lei No. 8884, 1994); Chile's *Comisión Resolutiva* (Resolutive Commission) under Decretos-Leyes Nos. 211, 1973 and 2760, 1979. Peru's appelate body for INDECOPI's decisions is the *Tribunal de Defensa de la Competencia*, which is an administrative tribunal (Article 13 Decreto Ley No. 25868.); the Costa Rican *Comisión para Promover la Competencia* (Comission for Promotion of Competition), has five members (Articles 18-27 Costa Rica's Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor, 1994); Mexico's *Comisión Federal de Competencia* (Federal Commission of Competition), five members (Articles 23-29 of the Mexican Ley Federal de Competencia Económica, 1992); Panama's *Comisión de Libre Competencia y Asuntos del Consumidor* (Free Competition and Consumer's Affairs Commission), three members (Articles 101-114 Panama's Ley No. 29, 1996) and finally, Peru's *Instituto Nacional de Defensa de la Competencia – INDECOPI* (National Institute for the Protection of Competition) with three members (Articles 4 and 5 of Decreto-Ley No. 25868, 1992)

169 Colombia's *Superintendencia de Industria y Comercio* (Superintendency of Industry and

Nevertheless, the similarities are more important than the differences. All these bodies normally enjoy a large degree of technical skill and functional autonomy, as their decisions on investigations and procedures are isolated from political interference. Sometimes autonomy is ensured through budgetary independence; in other cases through specific provisions which separate them from the rest of the Public Administration.[170] For example, it is common to find that their decisions cannot be brought to appeal before higher administrative bodies, but only before jurisdictional bodies.[171]

The appointment and removal of their members is generally subject to special conditions.[172] Sometimes, their tenure exceeds that of governments in office.[173] All these conditions are intended to reinforce their independence and political status.[174]

Commerce) under Decreto No. 2153, 1992 and Venezuela's *Superintendencia para la Promoción y Proteccion de la Libre Competencia* (Superintendencia Pro-Competencia) under the Ley para Promover y Proteger el Ejercicio de la Libre Competencia.

170 This is the case of Panama's Article 101 of Ley No. 29, which provides the *Comisión de Libre Competencia y Asuntos del Consumidor* with independent legal identity, internal autonomy and functional independence. Also, Mexico's Article 23 of the Ley Federal de Competencia Económica, provides the *Comisión Federal de Competencia* with technical and operative autonomy, and autonomy to issue resolutions. Similarly, Brazil's CADE enjoys autonomy in budgetary, personnel, and decision-making matters, according to Lei No. 9021, 1995. Finally, according to Article 19 of Venezuela's Ley Pro-Competencia, the *Superintendencia Pro-Competencia* has functional autonomy (but not budgetary).

171 Article 53 of Venezuela's Ley Pro-Competencia indicates that the decisions of the *Superintendencia Pro-Competencia* can only be appealed before administrative courts. Decisions of the Chilean *Comisión Resolutiva* can only be appealed before the Supreme Court (Article 19, Decretos-Leyes 211, 1973 and 2760, 1979).

172 A qualified seniority is required from candidates to head the antitrust agencies in Venezuela (30 years), Mexico (35 years), Argentina (30 years) and Brazil (30 years). Professional expertise and ethical standards are required by most statutes. The members of these agencies are often required to be either attorneys or economists (for example, Article 19 Costa Rican Ley de Promoción de la Competencia; Article 8 Argentina's Ley No. 22.262, 1980; Article 4 Brazil's Lei No. 8884, 1994)

173 Mexico's commissioners are appointed for renewable periods of ten years, and may only be removed in exceptional circumstances (Article 27, Ley Federal de Competencia Económica, 1992). Venezuela's Superintendent and Deputy Superintendent are appointed for four years, to avoid coinciding with the presidential term of five years (Article 22, Ley Pro-Competencia, 1992).

174 In some cases, independence is ensured by the appointment of representatives from different sectors of society, as a counterweight to government appointments (generally, the Ministry of Industry or the Ministry of Economy). For example, in Chile, the *Comisión Resolutiva* is formed

Finally, in some cases, antitrust enforcement activities are divided between two agencies, by additional prosecuting bodies. This is the case in Chile where the *Comisión Resolutiva* imposes administrative sanctions, and the *Fiscalía Nacional Económica* (National Economic Public Prosecutor) acts as a representative of the collective interest before the *Comisión Resolutiva* or the courts175. It is also the case in Brazil where the *Secretaría de Direito Econômico* is in charge of enforcing Brazil's antitrust laws. Finally, in Peru the *Tribunal de Defensa de la Competencia* is in charge of enforcement activities there.

b) <u>Jurisdiction of antitrust enforcement agencies.</u>

Antitrust rules apply in all Latin American statutes to all economic activities. However, there are significant exceptions worth mentioning.

Latin American antitrust enforcement seldom challenges legal rules enacted by Governments to create monopolies or restrict competition. Antitrust statutes commonly exclude enforcement and do not challenge legal rules which create obstacles to competition.176 This is another consequence of the structural bias of the policy, which wrongly emphasises the analysis of barriers alleged to be created by the dynamics of markets, and neglects to examine the sources of legal discrimination found in concessions, privileges and so on.

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by representatives of the Supreme Court, the Ministry of Economy, the Ministry of Finance, a Dean of a Law School and a Dean of a Faculty of Economics (Article 16 Chile's Decretos-Leyes 211, 1973 and 2760, 1979)

175 Article 24 Decretos-Leyes 211, 1973 and 2760, 1979. In theory, at least, all Latin American countries with antitrust schemes have *fiscalías generales* whose activities are independent of other branches of Government. These *fiscalías* are intended to protect individual rights from government or other interference. However, these bodies have traditionally been confined to political aspects of the protection of human rights; economic rights are not seen as part of their jurisdiction.

176 See, OAS, <u>Inventory...</u>, p. ii.

Clearly, neo-classical economic analysis has influenced the way in which antitrust agencies throughout the region interpret statutory legal provisions and determine the legality of business behaviour. As antitrust regulation is intended to correct a special kind of "market failure", it cannot be combined with other regulatory measures aimed at replacing unfettered market functioning by government fiat.

If markets do not meet optimal conditions they are immediately classed as "failures", because of externalities, monopolistic output restriction, or any other contingency calling for intervention. O'Driscoll and Rizzo describe the devices used to deal with market failure: taxation, regulation and antitrust. The logic behind the use of these regulatory mechanisms, means that whatever form is chosen to "correct" or "control" market failures will most likely preclude the other two.177 This explains why certain regulated sectors are excluded from antitrust enforcement; which, of course, applies particularly to the Latin American schemes.

In this regard, some antitrust regulations establish exceptions to enforcement in certain economic sectors; but such exemptions are not uniform. According to Tineo, these special regimes are established "either because the general (competition) system does not help to achieve the objectives of competition in cases of public utilities (natural monopolies) or because the social repercussions on other sectors are considered sensitive".178

Finally, certain monopolies are allowed where activities are regarded as strategic or where national security is allegedly involved. For example, in Mexico, Article 4 of the Ley Federal de Competencia Económica exempts nationalised "strategic industries" such as the oil industry and natural gas sectors and Articles 5 and 6 exempt trade unions and export co-operatives respectively. Similarly, Article 5 of Chilean Decree-Laws Nos. 211, 1973 and 2760, 1979 limits the enforcement of antitrust provisions in virtually every

177 G. O'Driscoll and M. Rizzo, The Economics of Time and Ignorance, (Oxford: Basil Blackwell, 1985), pp. 137-138.

178 L. Tineo, Competition Policy..., p. 8.

sector regulated by other legal provisions. These sectors include mining, oil production, public services, liquor production, health, banking, insurance, the stock market and transport. In Costa Rica, according to Article 9 of the Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor the following sectors are excluded from competition: insurance, alcohol distillery, fuel, public concessions, telecommunications, the telephone service, electric power and water services.

In general, most countries allow separate legal systems for certain public utilities and monopolies involving concessions or copyright. Hence, striking a balance between sectors subject to monopolies and those subject to privileges is not easy since political criteria tend to be involved. The general conviction here is that political reasons justify exemption from general competition rules.

Aside from these exceptions, it should be borne in mind that Latin American antitrust statutes apply to all national and foreign firms, regardless of their public or private ownership. In addition, they apply to every undertaking, type of conduct, agreement, act or transaction lending to the production marketing or distribution of goods and services.

Finally, following standards similar to those applied elsewhere, Latin American legislation incorporates an "effects doctrine" whereby, irrespective of national origin, any undertaking is prosecuted if it adversely affects domestic markets. Countries that are members of regional economic groupings such as the Andean Community or MERCOSUR, establish special provisions for the enforcement of common competition rules when the practice produces restrictive effects on competition in the integrated market.[179]

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179 The Andean Community (Venezuela, Colombia, Ecuador, Bolivia and Peru) and MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) are treaties to establishing common economic markets among these Latin American countries. Inspired by the Treaty of Rome in the European Union, both integration experiments provide for regional antitrust provisions. The Andean antitrust rules are embodied in *Decision 285* of the Andean Community, 1991 ("Rules to prevent or correct distortions on competition generated by restrictive business practices"). MERCOSUR's antitrust rules are embodied in the *Protocolo de Defesa da Concorrência do MERCOSUL, 1996* ("MERCOSUR's Protocol of Protection of Competition") Both Article 2 of *Decision 285* and Article 3 of *Protocolo de Defesa da Concorrência do MERCOSUL, 1996*

c) Administrative procedures.

Most Latin American jurisdictions follow administrative procedures for the investigation and prosecution of anti-competitive practices; in this respect, Latin American administrative legal rules follow Continental Europe's two-tier system, where procedures are initially conducted before an administrative agency and then before the courts. The existence of these specialised administrative agencies is seen to compensate for the claimants' lack of direct access to the courts whenever claims are brought before the administrative jurisdiction.[180]

Two kinds of administrative procedure are followed under Latin American antitrust statutes: the first deals with prosecution of restrictive conducts; the second with authorisation of undertakings with possible exemption from enforcement. Generally, these entail special administrative procedures and normally depart from the general rules on administrative procedures in other areas of intervention.

In the case of mergers, Latin American procedural schemes show considerable divergence. Some jurisdictions use authorisation procedures, in which merging firms are required to file a pre-merger notification.[181] Other countries merely establish a

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limit the scope of regional enforcement to conducts affecting the Andean Subregion and Mercosur, respectively.

180 Generally, the decision of the administrative agency on the anti-competitive nature of a restrictive undertaking or practice is needed before a civil action can be brought. However, in the case of "unfair competition", the statutes allow the victims more leeway to present their claims before the courts. Sometimes, filing a case before the court precludes filing the same claim before the administrative agency. The logic of this is based on the need to avoid contradictory decisions. For example, Article 55 of Venezuela's Ley Pro-Competencia allows affected parties to make claims before ordinary courts only after the *Superintendencia Pro-Competencia* has issued a final administrative decision.

181 See Articles 16-22 of Mexico's Ley Federal de Competencia Económica on "Concentrations"; and Brazil's Lei No. 8158, 1991 (today's Ley No. No. 8884, 1994) which states that "any agreements that limit or reduce competition, including mergers, whose consequence is a market share higher than 20% in the relevant market" must be approved by CADE. Finally, Venezuela's Superintendencia Pro-Competencia has developed a merger control system of dubious legality on the basis of a general clause in the Ley Pro-Competencia (Article 11), and complementary Regulation No. 2 on Mergers and Acquisitions.

requirement of notification for registration purposes, with varying consequences.[182] Some countries do not even possess specific merger procedures in their statutes.[183]

Finally, antitrust procedures may either be initiated *ex-oficio* or by any interested party.[184] Sometimes, however, ex-oficio prosecution begins only after a previous investigation has determined the likelihood of anti-competitive practices.[185] Again, this circumstance reveals the power granted to the State in deciding the existence of anti-competitive restrictions and classify them as matters of "public interest". However, antitrust laws in the region do acknowledge that individual rights are impaired by these restrictions, as they still provide for civil compensation to those affected. The affected party before must seek compensation through a civil court once the antitrust agency has determined the existence of an anti-competitive practice.

To carry out these activities, Latin American antitrust agencies generally enjoy broad powers allowing them to investigate economic sectors or particular firms, obtain evidence, to require co-operation from other governmental agencies, take preventative measures, and require evidence from private and public bodies.[186]

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182 For example, in Costa Rica, a rule-of-reason analysis is used for concentrations that limit competition (Article 16 Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor). In Panama, there is an ex-post merger notification system, with relatively severe consequences for mergers above prohibited levels. (Articles 19-26 Ley No. 26, 1996).

183 This is the case in Argentina, Chile and Peru; in these jurisdictions, concentrations are only prosecuted if they create a dominant position in the market. In the case of Argentina, however, Articles 9-16 in the new Competition Bill (expected to be passed by the end of 1997) develop a section on "Concentrations and Mergers", which provides for a pre-merger notification procedure. (See, Compilación de Legislación de la Competencia, América Latina y Caribe, Volumen 1, Comisión de las Comunidades Europeas, Dirección General de la Competencia, Bruselas, April 1997, pp. 36-37.)

184 For example, Article 17 Argentina's Ley 22.262; Article 32 of Venezuela's Ley Pro-Competencia; Article 30 of Mexico's Ley Federal de Competencia Económica; and Article 15 of Peru's Decreto Legislativo No. 701.

185 For example, Articles 30 and 31 of Brazil's provide for a 30-day period of preliminary investigations after which proceedings may be initiated. Venezuela's administrative practice also grants a period for preliminary investigations before a case is brought *ex-oficio*.

186 The provisions regulating these powers are as follows: Article 12 Argentina's Ley No. 22.262, 1980; Article 7 Brazil's Lei No. 8884, 1994; Articles 17 and 24 Chile's Decretos-Leyes 211, 1973 and 2760, 1979; Colombia's Código Contencioso-Administrativo; Peru's Decreto-

Antitrust agencies are sometimes granted powers to regulate their own decision-making activity with rules and official guidelines.[187] Agencies have often resorted to issuing "opinions", which clarify the legality of an actual or potential undertaking in connection with a particular firm.[188]

d) Legal sanctions.

Legal sanctions come in the form of administrative fines imposed for breaching "public order" (hence, their administrative nature). In some cases, a breach may also lead to civil damages, which only affected firms may claim.[189]

The fines for breaching antitrust statutes, which can be very high, are ultimately determined by the seriousness of the distortion caused in the market and by taking into account the income of the company which caused the infringement, as in Venezuela; fines are also indexed to a minimum wage or fiscal unit as in Mexico and Brazil.[190]

Legislativo No. 807; Venezuela's Article 34 Ley Pro-Competencia; Mexico's Article 31 Ley Federal de Competencia Económica; Article 24 Cost Rica's Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor, 1994; Article 103 Panama's Ley No. 29, 1996.

187 According to the general principles of administrative law prevailing in all the Latin American jurisdictions, these administrative authorities may interpret their own rulings and create guidelines from them. They may also change their former rulings in future cases. The change in the interpretation given to administrative activity makes the formulation of guidelines useful, as these authorities become bound by them. For example, Venezuela's *Superintendencia Pro-Competencia* has issued instructions on the interpretation of the Exemptions Regime (Instructivo No. 1, 1993), and the notification of mergers and acquisitions (Instructivo No. 2, 1994).

188 Mexico's Article 24. 7 Ley Federal de Competencia Económica; Venezuela's Article 21 of Regulation No.1; Costa Rica's Article 24 f) Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor; Panama's Article 103.10 Ley No. 29, 1996.

189 For example, Article 55 of Venezuela's Ley Pro-Competencia; also, Article 27 of Panama's Ley No. 26, 1996; Article 25 of Peru's Decreto Legislativo No. 701, 1991.

190 Article 49 of Ley Pro-Competencia, allows the *Superintendencia* to impose a fine up to 20% of the value of sales in the year preceding the decision. Similarly, under Article 23 of Brazil's Lei No. 8884, 1994 fines may consist of up to 30% of the year's turnover, or up to six million in Fiscal Reference Units. In Mexico, under Article 35 of Ley Federal de Competencia Económica, fines may reach up to 375,000 minimum wages.

Some conduct which is regarded as extremely reckless or socially harmful can even entail criminal prosecution and short prison terms under some Latin American antitrust statutes; this is the case in Argentina, Chile and Peru.[191]

3.2.- <u>Administrative and judicial control in antitrust enforcement</u>.

The are formal differences between national jurisdictions with regard to the procedures followed for administrative and judicial review. In some countries such as Costa Rica, Colombia and Mexico, legal rules provide for a review of cases by the antitrust agency or a higher administrative body.[192] In other cases, such as in Chile, Brazil and Venezuela, decisions are only reviewed by the courts. In Peru, decisions adopted by INDECOPI are reviewed by the *Tribunal de Defensa de la Competencia*.[193]

Notwithstanding these differences, it is agreed that the design of competition policies should follow certain basic and general principles of policy enforcement, irrespective of the country-specific environment. Khemani and Dutz observe that these principles are essential for deciding whether the implementation of competition policy in developing countries is useful. They argue that many opponents of this legislation emphasise the lack of specialised staff, poor institutional knowledge and the absence of a tradition of analytical rigor needed to ensure beneficial interventions.[194]

Consequently, certain principles must be guaranteed to ensure that enforcement will be correctly exercised. Firstly, the agency should be independent and isolated from

191 Specifically, Article 42 of Argentina's Ley No. 22.262, 1980; Article 1 of Chile's Decree 211, 1973 and 2760, 1979; and Article 19 of Peru's Decreto Legislativo No. 701, 1991.

192 See Article 61 of Costa Rica's Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor, 1994; Article 39 of the Mexican Ley Federal de Competencia Económica allows a reconsideration within 30 days of notification of the decision.

193 Article 13 of Decreto Ley No. 25868. The Tribunal is an administrative court; its decisions are only subject to appeal before the Peruvian Supreme Court (Article 17).

194 Khemany and Dutz, pp. 27-28.

political interference and budgetary constraints. Secondly, it must be accountable: one way to ensure this is to require the publication of an annual report for submission to the legislature or a special committee. Thirdly, competition law should separate the investigative, prosecutorial, and adjudicative functions. This prevents the antitrust agency from becoming investigator, judge, prosecutor and jury at the same time. Fourthly, the process should incorporate a system of checks and balances that guarantee the right to appear before the authority, allow a review of decisions taken, and given access to information on the legal and economic interpretation of the law. Administrative procedures and regulations must be transparent. The proceedings and resolution of cases should be expeditious to avoid unnecessary business-related costs and commercially sensitive business information should be safeguarded.195 Finally, to deter anti-competitive practices, the law should establish penalties, including meaningful fines and other remedial measures.196

The reason for the insistence on incorporating these "safeguard" principles is based on the unwarranted assumption that the legal system can provide effective judicial control over antitrust enforcement. In other words, these scholars concentrate on the procedural mechanisms of due process to ensure that the rule of law will be preserved. This is a central concern among antitrust scholars, as was emphasised at an important international antitrust meeting recently held in Europe. Antitrust schemes should be designed to be "user-friendly", meaning that the enforcement of rules must maintain certain essential elements, such as transparency, efficiency, consistency and substantiveness.197 The

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195 Some statutes provide for the confidentiality of the information submitted. For example, Article 31 of Mexico's Ley Federal de Competencia Economica subjects government officials to administrative penalties if they make this information public. Similarly, Article 31 of Venezuela's Ley Pro-Competencia establishes the confidentiality of the information on these proceedings. Confidentiality applies to the prohibition on disclosure of pertinent information to the public; obviously it does not apply to the parties involved in the proceedings, as concealing such information from them would impair their rights to *due process*.

196 Khemany and Dutz, p. 28.

197 See D. P. Wood, "User-Friendly Competition Law in the United States", in Procedure and Enforcement in E.C. and U.S. Competition Law, Pier Jan Slot and Alison McDonell (eds.) (London: Sweet & Maxwell, 1993), pp. 6-18. However, it is unlikely that focusing on procedural aspects will correct any of the *substantive* deficiencies and potential excesses associated with antitrust policy enforcement.

positivistic view of the law has confined legal scholars to seeking means to redress abuses by Authority on mere procedural rather than substantive grounds. Effective institutions for the protection of economic rights, such as the ombudsman, are almost non-existent. At best, the protection of these rights is confined to political or procedural rights (freedom of speech; habeas corpus, etc.). The real substantive obstructions to economic activities, implemented through devices such as licences, price controls, output restrictions, tariffs, authorisations to trade, and so forth, are easily justified as protection of some vague form of "public interest".

4.- CONCLUSIONS: THE IMPLICATIONS OF CLOSED-END ANALYSIS IN THE DESIGN OF ANTITRUST REGULATION IN LATIN AMERICA.

The ideas that emerged in the nineteenth century changed the method of analysis in social sciences, and consequently legal scholars' and economists' perceptions of social phenomena. This change led to a wholesale reappraisal of the agenda of scientific research and formulation of public policies. Scientific research shifted its emphasis from analysis of entrepreneurial interaction to the essentially neo-classical mathematical formalistic science in an attempt to measure social phenomena through abstract positive economic equilibrium models. In the crucial period of 1870-1920, economists became more interested in developing mathematical models to explain anonymous *static* market forces, rather than their previous emphasis on examining the *dynamic* interaction of entrepreneurs in the market. Perceiving reality in closed-end terms inevitably introduced an assumption of omniscience among social scientists. They became excessively optimistic about the chances of moulding reality to predetermined goals by means of issuing collective orders.

In the domain of public policy, this theoretical appraisal had far-reaching implications. Until that point, the economics profession had agreed on the positive effects of the division of labour and economic exchange on economic development. Classical economists viewed economic exchange as a process *pursuant to* equilibrium: not *within* equilibrium. Their focus was therefore reliant upon the institutions moulding economic exchange, rather than economic exchange alone. Under their appraisal, there could be no flaws inherent to market functioning, but simply foregone opportunities overlooked by less alert entrepreneurs. Only contrived artificial restraints such as privileges or legal monopolies could introduce exogenous distortions in the process of exchange. By contrast, under neo-classical equilibrium appraisal, any departure from the perfectly competitive equilibrium appeared as a failure that could be prevented or corrected by proper intervention. A completely different normative appraisal of capitalism ensued.[198]

In the case of developing economies these considerations are all the more important, as the alleged existence of negative externalities and market failures prompted the suspicion that capitalism and unfettered market functioning could not be an adequate tool for development. Machovec links the intellectual genesis of these policies to the neo-classical notion of market failures, whose presence in developing countries is presumably due to the concentrated structure of their domestic economies.[199]

According to these views, it is only necessary to identify those special features that represent some particular class of market failures in developing countries, in order to adopt the necessary correctives through purposive legislation. In this regard, Todaro argued: "the existence in developing countries of numerous deviations from perfectly competitive norms ('market failures') justifies substantial public intervention to offset their utility-reducing impact".[200]

This context explains the introduction of antitrust policy in Latin America. The formulation of policy-making in the region has been dominated by successive "public interest" goals considered to be socially relevant. Formerly, these goals were associated

198 Machovec provides an explanation of the causes and consequences of this evolution of economic theory: "The adoption of perfect information modelling as the heart of neo-classical economics transformed the way economists were trained to think about the institution known as the market. Under the classical regime (and into the early 1920s), economists saw the market as a process though which entrepreneurs earned profit and discovered what to produce and how to produce. Under the perfect-information regime, what and how become the known ends and means, and the market became a computer for providing the equilibrium magnitudes. This new mental framework led to a pro-government disposition in several key areas." (Machovec, p. 300.)

199 Machovec, p. 59.

200 Machovec, p. 61.

with the promotion of development through the creation of "sovereign" domestic industries capable of making Latin American consumers independent of foreign capitalist interests. The failure of such policies turned the attention of policy-makers to the possibility of implementing market-oriented policies. However, markets were examined under the pervasive neo-classical theories that presented them as weak structures prone to "fail" unless governments intervened.

The theoretical framework summarised above considers the manifold expressions of market malfunctioning to be responsible for the lack of entrepreneurial spirit evident among so many Latin American firms. Following this logic, antitrust policy in Latin America is regarded as a preventive or corrective tool to eliminate what many perceive to be obstructions to market functioning, produced (according to this perception) by high levels of economic concentration. Its goal is to ensure that market transparency, free from distortions, ensures optimum outcomes. Aside from antitrust policy, the *market failure logic* invites policy-makers (in Latin America and elsewhere) to regulate otherwise voluntary transactions by means of a variety of government initiatives involving different regulatory devices. In fact, within the range of policies based on the market-failure premise, antitrust policy appears more compatible with market functioning, at least when compared with other types of regulation. In contrast to other initiatives aimed at wealth redistribution, antitrust policy expressly states its intention to improve market functioning, sometimes even at the expense of redistribution.

However, the market failure explanation seems at odds with Latin American reality. Economic history clearly shows that market concentration in the region emerged from development policies that relied heavily on government intervention, rather than market dynamics. Government intervention ruled virtually every aspect of business and economic life. As explained above, Latin American policy-makers sought to protect domestic industries from foreign competition in an effort to develop domestic industries and thereby foster development. Private property rights and contractual freedom were subject to numerous legal and de facto conditions that eroded their serviceability. Voluntary interaction was constantly curtailed in the name of *public interest*, which proclaimed the intention of promoting domestic growth and development. Under this regime of institutional privileges and official monopolies, protected industries gradually turned into inefficient industries incapable of promoting economic growth, innovation and entrepreneurship. In fact, if anything has prompted economic reform in the region, it is an honest desire to eliminate these obstructions in order to allow markets to operate freely. In the light of Latin America's institutional reforms, the question is whether antitrust policy is capable of eliminating such restrictions and fostering competition, or whether policy-makers should attempt alternative initiatives.

In this regard, an important conclusion can be made from this chapter about the type of intervention under the conventional paradigm of regulation, and the substance of legal rules comprising the conventional paradigm.

Legal rules are merely instruments of authority designed to achieve social outcomes regarded as "just" or desirable according to an "external" normative criterion. In the particular case of antitrust legal rules, this criterion may be represented by the Pareto standard of economic efficiency (albeit this is not the only representation of social welfare that this policy might pursue) as the enforcement experience of many jurisdictions suggest.

These social welfare standards define an "optimum" world against which market transactions appear as "imperfections" which require some correction through antitrust policy. The application of the policy contains several implicit assumptions:

Firstly, *policy-makers possess all the information* necessary to make a proper cost-benefit appraisal to maximise benefits and minimise costs to society as a whole. In other words, the ruler possesses objective omniscient knowledge, even of information missing from the system, thus creating asymmetries of information among economic agents which impedes efficient social resource allocation.[201] This information relates to the most efficient means of allocation of social resources according to the tastes, preferences, and personal goals of the individuals affected, but is also assumed to be unchanging. In other

201 G. F. Thirlby, The Ruler, in 'L.S.E. Essays on Cost, J. Buchanan and G. Thirlby (eds.), New York Unversity Press, 1981, pp. 165-198.

words, policy measures are designed and enforced on the basis of the information gathered from the social system at the particular moment of its adoption; they cannot incorporate unforeseen information resulting from subsequent changes in the social setting.

Secondly, in closed-end view of markets, market outcomes resulting from economic interaction can be predetermined. The question then is how to allocate resources to achieve those outcomes regarded as most efficient. A given measure will be judged "good" if by following the objective standard, it improves the allocation of social resources. In other words, allocation of resources takes priority over any other possible by-product of the interaction itself.

Thirdly, it is assumed that legal rules can be worded in such a way thatthe policy-maker is able to gather all the relevant information needed for ascertaining the social welfare goal (or the instances where the social welfare goal is unfulfilled in reality). Also, it is assumed that the information which could identify the means to correct any failure or imperfection of the system will be readily available.

These considerations are important with regard to the particular features of the way this regulation has been implemented in Latin America. The closed-end bias of the theory underlying antitrust policy is currently guiding enforcement of this policy in Latin America. The institutions designed to enforce antitrust are following the principles laid down by antitrust theory. These principles have been adapted to the legal structure of Latin American countries, which is based on the Civil Law system. There are some exceptions arising from the need to harmonise the legislation with economic integration agreements.

All the schemes base their efforts at enforcement on an administrative authority. This authority is given considerable powers to conduct investigations, and make substantive determinations about the existence of monopolistic practices. For this reason, an important concern has been to ensure the accountability of antitrust agencies, which, it is generally agreed, has been achieved through the existence of procedural requirements, such as *due process*. The question remains, however, as to whether it is possible to subject antitrust enforcement to more transparent parameters or objective criteria in the substantive determination of the existence of illegal practices. Until now, judges have only succeeded in developing certain vague proxies in relation to conducts that should be regarded as monopolistic.

It seems as if the conjunction between law and economics under the neo-classical structural appraisal has severe limitations that prevent the emergence of a stable rule of law. In this regard, Richard Epstein defined the central role of neo-classical economic theory in its support of antitrust premises. In his opinion, "the economic edifice might not be perfect, but economics is the only public policy game in town, and its basic conclusions must be beaten back within its own terms and its own premises".[202] For this reason, criticism of antitrust policy in the last instance has to rely on a broader critique of the neo-classical structural paradigm on which it was founded. This is exactly what we shall attempt in the next chapter.

202 Epstein, Private Property..., at 55.

CHAPTER III.- THE IMPLICATIONS OF A SUBJECTIVE APPRAISAL OF MARKET RELATIONS ON THE VALIDITY OF ANTITRUST LEGAL DOCTRINES UNDER THE RULE OF LAW.

"It seems to me that many of the current disputes with regard to both economic theory and economic policy have their common origin in a misconception about the nature of the economic problem of society. This misconception in turn is due to an erroneous transfer to social phenomena of the habits of thought we have developed in dealing with the phenomena of nature."

(F. A. Hayek, The Use of Knowledge in Society p. 78)

1.- THE ECONOMIC AND LEGAL CONSEQUENCES OF A MISGUIDED PERCEPTION OF MARKET PHENOMENA UNDER CONVENTIONAL REGULATORY APPRAISAL.

1.1.- Epistemological misuse of equilibrium models in the analysis of market phenomena.

The essential flaws of conventional market analysis are related to the influence of formalism on economic theory. Formalism introduced a trend whereby equilibrium models started to be put to a misleading use. In this way the perceptions construed from the misuse of these models were responsible for misrepresenting the evolutionary essence of social phenomena. This limitation has been particularly noticeable in the realm of market analysis, where these models seem to have lost touch with the reality they purport to explain.

The problem with the way in which scholars visualised reality under conventional regulatory appraisal stems from the heuristic use of equilibrium for apprehending the essence of real markets. Initially, regarding equilibrium as an "ideal type" posited no problems because under this appraisal the question concerned how departures from the equilibrium may constitute forms of incomplete success: "An ideal type is neither intended to describe reality nor to indict it. It is instead a theoretical construct intended to illuminate certain things that might occur in reality; empirical investigation determines whether these phenomena are actually present and how they came to be there."[203] As a

203 Boettke, What Went Wrong with Economics? at 23

methodological device this epistemology merely purported to explain the world from the perspective of what *could be* at equilibrium or away from it, but it did not attempt to make any comparison between these two essentially different entities.

However, the formalist revolution in economic thinking in the 1930s abandoned this use and adopted a perspective which attempted *to compare* reality with models. In this way, reality was idealised "to the point of utopianism". Either reality was thought to approximate equilibrium or was regarded as dystopia.[204]

The problem ultimately lies within the formalism of conventional economic appraisal, which denies the very phenomenon it is supposed to examine; namely, that the world is in permanent disequilibrium. Indeed, the very idea of perfect information (accruing at equilibrium) contradicts any sense of motion in this system; individuals' motivations to act are in fact by-products of the imperfect foresight of other participants.[205]

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204 As Boettke argues, "the departures of reality from the model of perfect competition were now thought to highlight interventions in the market economy that would be necessary to approximate equilibrium. Competitive equilibrium and the maximising behaviour that would ideally produce it represented the hard core of the research program of economists from 1950 on. As this happened, economics as a discipline was transformed." He concludes, "formalism led to utopianism". (Id. at 19.)

205 Morgerstern showed that, when one individual's plan is dependent on that of another, perfect knowledge will produce "an endless chain of reciprocally conjectural reactions and counter-reactions" leading to a standstill. (O. Morgerstern, "Perfect Foresight and Economic Equilibrium", Zeitschrift für Nationalökonomie *6* (part 3). Trans. F. H. Knight in A. Schotter (ed.), Selected Writings of Oskar Morgerstern, (New York: New York University Press, 1976), p. 250. He illustrated this point with the Holmes-Moriarty story, which is worth quoting in full: "Sherlock Holmes, pursued by his opponent, Moriarty, leaves London for Dover. The train stops at a station on the way, and he alights there rather than travelling on to Dover. He has seen Moriarty in the railway station, recognizes that he is very clever and expects that Moriarty will take a faster special train in order to catch him in Dover. Holmes' anticipation turns out to be correct. But what if Moriarty had been still more clever, had estimated Holmes' mental abilities and had foreseen his actions accordingly? Then, obviously, he would have travelled to the intermediate station. Holmes, again, would have had to calculate that and he himself would have decided to go on to Dover. Whereupon, Moriarty would again have "reacted" differently. Because of so much thinking they might not have been able to act at all or the intellectually weaker of the two would have surrendered in the Victoria Station, since the whole flight would have become unnecessary". (Morgerstern, pp. 173-174, quoted by O'Driscoll and Rizzo, p. 84). The moral of the story is that perfect knowledge of each other's plans makes attainment of such equilibrium impossible; *motion* (such as competition) is, by definition, excluded from the system.

Equilibrium models eliminate all consideration of the idea of motion which pervades rivalry and competition. Addleson has pointed out that the neo-classical model leaves out many questions essential for comprehending the sense ordinarily given to the term "competition": "[The] questions that need to be answered, but which a 'system view' obscures, include: What are competitive activities? Who competes with whom? On what basis, or what by means, do businesses compete?"[206]

Neo-classical scholars attempted to overcome this limitation, and to depict reality more accurately in their analyses by defining intermediate models between Pure Monopoly and Perfect Competition such as "monopolistic competition" or "imperfect competition". These models were taken to be a faithful expression of market transactions as they operate in the real world. Robinson herself was lured into the fallacy of assuming that ideal models could somehow replicate reality, as is clearly shown in her endeavours to create a link with the real world simply by relaxing the extreme assumptions of the models of Perfect Competition and Pure Monopoly. In her words: "A simple analysis can only be made upon simple assumptions and the more complicated the analysis, the more complicated the assumptions upon which it will work, and the nearer the assumptions can be to the complicated conditions of the real world. The practical man must be asked to have patience, and meanwhile the economist must perfect his tools in the hope of being able sooner or later to meet the practical man's requirements. (...) If those assumptions are near enough to the actual conditions to make the answer serviceable the practical man can accept it, but if the assumptions are very abstract the economist will only bring the practical man into confusion and himself into disrepute by allowing him to suppose that the question which is being answered is the same as the question which is being asked".[207] To make her assumptions more *realistic*, and therefore to make economic theory useful to the *practical man*, Robinson moved from the Perfect Competition model into models depicting less-than-optimal situations. However, she did not realise that these models were as idealistic as the former ones, did not therefore get any closer to the "real

206 Addleson, p. 100.

207 Robinson, The Economics..., p. 2.

world". Edward Chamberlin also attempted to restore realism by constructing models of monopolistic competition that consider the role of reputation and product differentiation in market behaviour.[208]

However, finding a middle ground did not narrow the gap between these models and conditions in the real world. The models of *imperfect* or *monopolistic* competition were no less "objective", and *in this sense*, incapable of appraising the subjectivism of competition processes. Kirzner deals with this question in the following terms: "Chamberlin's attempt to restore realism by constructing models of monopolistic competition missed the mark. He did not recognise that the source of the offending unrealism lay in the assumption of already-attained equilibrium in the perfect competition model. What he proposed instead was a more complicated equilibrium model. The model of attained monopolistically competitive equilibrium is in a number of respects less insulting to our sense of realism than the model it sought to replace; nonetheless, the new model suffers from the same cardinal fault. By postulating already-attained equilibrium it cannot explain how equilibrium might come to be approached. The theory misses the opportunity to provide a satisfactory explanation by considering the disequilibrium features of the market."[209]

It is a fallacy to assume that reality is somehow closer to "intermediate" models of monopolistic competition, and that they could therefore be useful "guideposts" for

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208 Ekelund and Hébert, pp. 484-510.

209 I. Kirzner, How Markets Work: Disequilibrium, Entrepreneurship and Discovery, IEA Hobart Paper, No. 133 (London: Institute of Economic Affairs, 1997), p. 30. Richardson observes in this regard: "the theory of monopolistic competition is hardly more useful than that of perfect competition in enabling us to understand the working of an actual competitive economy. Its assumptions represent, in comparison with those of perfect competition, a step nearer reality; in particular it places a desirable emphasis on product variation and on selling costs; but, from other points of view, it represents a less radical theoretical departure than is sometimes supposed. (Indeed), the theory, like that of perfect competition, effectively ignores the informational properties of economic systems. The question whether, under the arrangements postulated, entrepreneurs would be able to form reliable expectations, is simply not raised, and decisions are assumed to be taken merely on the basis of current demand and cost conditions. Both theories are dominated by the concept of equilibrium, although neither really succeed in showing how in fact it could be attained; they fail to focus attention on the process of change or adaptation in itself, although it is this which is most urgently in need of explanation". (Richardson, Information..., pp. 111-112)

regulation of markets. This is clearly not the case because the models do not take into consideration the way in which information changes constantly, in a way that cannot be foretold. Indeed, there is always the assumption in all these models that the external observer knows the information necessary to predict future outcomes. Even under models which depict how information is spread unevenly amongst economic agents, the outside observer *knows* how much information is missing for each participant, and how much information is needed to enable the system to achieve equilibrium. In the end this is yet another form of omniscience.

Many social scientists attached properties to the neo-classical equilibrium model for which it was clearly unfit, because they distorted its original purpose. The Perfect Competition model was never intended to become a standard against which reality could be compared. In fact, neo-classical scholars have constantly emphasised that the lack of realism in the assumptions under which they frame their models does not diminish the value of the models as reliable predictors. Under the positivist method, demanding *realism* from the assumptions on which positive models rely is irrelevant, both in terms of prediction, as Friedman said, and in terms of explanation, as Popper clearly argued.[210] The models were therefore not supposed to "represent" reality, only to interpret it. In order to explain how resource allocation varies under abstract states of equilibria, neo-classical models had to idealise the operation of market forces. However, the interpretation given by many scholars went well beyond a mere representation of reality.

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210 Friedman argues that it is irrelevant whether the assumptions of positive models are real or fictitious; what is relevant is that they can provide us with proper predictions of what would happen in reality if other conditions remained constant. The purpose of positive models is not to depict reality as it is, but to create a tool to understand how individuals behave "as if" certain forces are guiding their action. In other words, they are nothing but models, which were never intended to become normative references for measuring reality. (See M. Friedman, "The Methodology of Positive Economics", Essays in Positive Economics, M. Friedman (ed.), (Chicago: The University of Chicago Press, 1953.) In a similar fashion, Popper contended that it is impossible to verify the model of Perfect Competition, given that the essence of "models" is that they are metaphysical statements. If this is the case, then we will have to accept the implications of the model as a matter of logical deduction, and admit that the world may reach a state of perfect competition. In this case, however, it is crucial for the model to replicate the world. But this is not so simple, as models in economics are merely tools for expressing certain relationships in mathematical terms. Reality, as Popper has indicated, is a non-verifiable issue, and therefore beyond the realm of science. (See D. Papineau, "Philosophy of Science", in The Blackwell Companion to Philosophy, N. Bunnin and E. P. Tsui-James, (Ed.), (Oxford: Blackwell Reference, 1996), pp. 290-324.)

The source of this confusion probably stems from the positivistic inclination to grant empirical evidence an unjustified weight in the demonstration of hypothetical predictions of social phenomena. This made neo-classical scholars tend to assume that the essence of reality could be grasped by incorporating traits or features into these models which they regarded as "realistic" expressions of the real world, as perceived through sensorial experience. They were thus inclined to assume that models incorporating conditions such as "reputation", "advertising", and so forth, were closer to reality because these are elements found in reality. Their positivistic approach made them prone to subject their theoretical appraisal to the empirical evidence of their observations of the real world.

In other words, scholars arbitrarily chose hypotheses that depicted causalities or regularities they perceived to be the expression of a "more realistic world" and incorporated them into the models, resulting in truly arbitrary interpretations of social phenomena and opening a "Pandora's Box". Schumpeter clearly saw a lack of scientific rigor in this: "Both economists and popular writers have once more run away with some fragments of reality they happened to grasp. These fragments themselves were mostly seen correctly. Their formal properties were mostly developed correctly. But no conclusions about capitalist reality as a whole follow from such fragmentary analyses. If we draw them nevertheless, we can be right only by accident. That has been done. And the lucky accident did not happen."[211]

Consequently, social scientists fell into the trap of assuming that empirical data alone is a source of knowledge about reality. They assumed that their models, tested with such empirical evidence, could provide an objective explanation of social phenomena and that the interpretation of those "facts" could be separated from the values of the observer.

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211 J. Schumpeter, Capitalism, Socialism and Democracy, (New York: Harper & Row Publishers, [1942] 1950), p. 82.

Clearly, this was not could not be the case since such methodological positivism was unfit to examine reciprocal interpretations of social phenomena.[212]

Mises pointed out these epistemological inconsistencies a long time ago.[213] He showed how conventional economic thinking stems from the misconception that economic behaviour can be assimilated with natural phenomena. Conventional economic science is dominated by a false belief, namely that of assuming that human behaviour can somehow be assimilated into perceived regularities easily observed in the empirical evidence gathered from physical and natural events. These regularities take the form of "laws", which can be framed by observing past patterns of behaviour. Yet, this kind of analysis is misleading in the case of economics. Human beings, which from the substratum of economic analysis, behave purposefully, pursuing individual goals which cannot possibly be predicted.[214]

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212 Perhaps Lachmann made the most eloquent criticism against the use of positivism for examining human conduct. Specifically, he contended: "How can a system of pure logic, like that of the logic of choice (characterising market phenomena), provide factual knowledge? The answer follows from the essence of my thesis: the distinction between logic and factual knowledge is justified in the realm of nature, where no meaning is directly accessible to us, and in which care must thus constantly be taken to distinguish between our concepts and reality. In the realm of human action it is different. Here such a distinction seems unjustified. On the one hand we are unable to verify or falsify our schemes of thought as hypotheses by predicting concrete events. Scientific tests are not available to us since their require a complete description of that concrete 'starting position' in which the test is to take place. Every human action, however, depends on the state of knowledge of the actors. A verification test therefore would require an exhaustive description of the state of knowledge of all actors, also according to the mode of distribution –an obvious impossibility. Otherwise, however, the starting position is not exactly defined, and no real test is possible. In economics this means that every concrete transaction depends, among other things, on the expectations of the participants. To test an economic theory *in concreto*, we must, then, be able, at the point of time of theory formulation, to predict the expectations of economic agents at the (future) point of time of the verification test." (L. Lachmann, "The Significance of the Austrian School of Economics in the History of Ideas" in Capital, Expectations and the Market Process: Essays on the Theory of the Market Economy, Institute for Humane Studies, (Kansas City: Sheed Andrews and McMeel, Inc., 1977), pp. 57-58.)

213 L. Mises, The Ultimate Foundation of Economic Science: An Essay on Method, Van Nostrand Company, Inc., Princeton-New Jersey, 1962.

214 Mises.observes in this connection: "Economics is not about things and tangible material objects; it is about men, their meanings and actions. Goods, commodities, and wealth and all the other notions of conduct are not elements of nature; they are elements of human meaning and conduct. He who wants to deal with them must not look at the external world; he must search for them in the meaning of acting men." (Mises, p. 92.)

Clearly, the positive method has been extremely useful in detecting relationships amongst its own elements, particularly in the idealistic Perfect Competition model, whose logic, as we have seen, is based on *impersonal* mathematical relationships. However, for these very reasons, it is a poor method of social analysis for appraising the complexity of reality and the factors motivating human action.215 This limitation was commented on by Isaiah Berlin, who stressed that the attempt to press political studies into a natural scientific framework had obscured many of the issues that were indispensable to the understanding of political life.216 Loughlin makes similar remarks with regard to the effects of positivism on legal method: "Just as the attempt to press political studies into a natural scientific framework has distorted and obscured many of the issues that are indispensable to an understanding of political life, so also this claim may be made for law. The conception of law which we obtain from the formalist approach and the adoption of the analytical method obscures more than it reveals."217

For these reasons, it is impossible to make predictions about the future behaviour of firms based solely on statistical economic data. It is simplistic to assume that predictions made in the working of these abstract market forces somehow indicates how flesh-and-blood entrepreneurs would react similarly under similar conditions. As Rizzo contends, the predictability of the causality between two factors in a model cannot be translatable into real world predictability, because "the contrary assumption merely demonstrates the fallacy of misplaced concreteness".218 For this reason, an essential premise of antitrust theory is the assumption that past market dominance will dictate or "control" the terms of future market transactions.219

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215 M. Rothbard, "Praxeology as the Method of Economics", in Phenomenology and the Social Sciences Vol. 2., M. Natanson, (ed.), (Evaston: Northwestern University Press, 1973.)

216 I. Berlin, 'Does political theory still exist?' in P. Laslett and W. G. Runciman (eds.), Philosophy, Politics and Society (Second Series), (Oxford, 1962), p. 1, quoted by Loughlin, p. 29. Mises also contended emphatically that attempts to apply natural science methods to social science were misguided because they neglected the purposive nature of human action, which is guided by goals, not impersonal regularities. (See Mises, The Ultimate Foundation...)

217 Loughlin, p. 41.

218 M. Rizzo, "Disequilibrium and All That: An Introductory Essay" in Time, Uncertainty and Disequilibrium, M. Rizzo (Ed.), Lexington Books, Toronto, 1979, p. 3.

219 In the words of Sowell: "Antitrust laws, like all forms of third party monitoring, depend for their

It is also necessary to understand the role that equilibrium plays in economic analysis. Its significance will ultimately depend on the use we attach to it for heuristic purposes: "Whether we view equilibrium in [dynamic terms] or take a more conservative [static] position is purely a matter of heuristic and analytic convenience. Indeed, the notion of equilibrium, (...) is only a mental tool without any direct operational significance. Depending on the purpose at hand we may use either (...) concept".220 Ultimately, everything comes down to one simple question: What is the 'level of reality' we are interested in?221 Under this perspective, the goal of scientific inquiry will not be to discover how equilibrium (or any position in relation to it, for that matter) operates in reality, because such equilibrium exists only in our minds.

Instead, the question is whether the changing causalities of market interaction can be examined through the lenses of equilibrium, by way of counterfactual analysis. O'Driscoll and Rizzo deny this possibility in categorical terms: "The received theory of competition is comparatively static, focusing on beginning and end points. Economic agents are interested in neither the beginning nor the end points, but in coping with never-ending adjustments. The theory of perfect competition analyzes the state of affairs or equilibrium conditions that would exist if all competitive activity ceased. *It is not an approximation but the negation of that activity*". (Original italics)222 For this reason, a

social effectiveness on the articulation of characteristics objectively observable in retrospect, which may or may not capture the decision-making process as it appeared prospectively to the agents involved" (Sowell, p. 205). For this reason, this author argues, "antitrust proponents have scored a verbal coup by constantly terming such percentages the "share" of the market "controlled" by certain firms, as if they were discussing prospective behaviour rather than retrospective numbers." (Id., p. 205).

220 Rizzo, p. 6.

221 O'Driscoll and Rizzo, p. 17.

222 O'Driscoll and Rizzo, pp. 97- 98. In a similar fashion, Kirzner has stated: "The [conventional] story, even allowing for the deliberate simplifications sought for the sake of didactic effectiveness, is disturbing. To assume that everyone is, at each instant, asking and receiving the same price is to assume away the possibility of price competition or, alternatively, to assume that competition achieves its results instantaneously. If we wish to understand the competitive process of supply and demand more adequately, we must amplify the textbook story to recognise that different sellers and different buyers may be charging different prices". (Kirzner, Discovery..., p. 2)

meaningful analysis should explain relationships that can occur in the disequilibrium of the marketplace since they are the essence of the process under examination. As Kirzner states, "no matter how illuminating such a picture may be in providing *in*direct clues as to how such a configuration of decisions might come to be attained, it cannot of itself portray any such [equilibrating] process [as found in reality]. Any adjustments needed to achieve this equilibrium configuration must have occurred prior to the moment pictured in the equilibrium model. Thus a view, which sees the world as *at all times* in the relevant attained states of equilibrium, clearly *rules out all the adjustments which might have made such attainment possible*." (Original italics)[223]

It is not possible for this methodology to explain how market participants interact in such a way that they eventually reach equilibrium. Indeed, a closer look reveals that the methodology does not solve this problem at all, because it simply stipulates the conditions (i.e., perfect knowledge) within which such equilibrium would occur. In other words, it does not provide explanation but it describes the explananda. Explaining the on-going change which leads to equilibrium is inherently impossible to this methodology.[224] As Kirzner contends: "A model in which perfect knowledge is assumed is necessarily a model of already attained equilibrium: it cannot grapple with the process in which imperfect mutual knowledge may tend (or fail to tend) to generate improved mutual knowledge. Consequently, quite apart from the unrealistic character of the perfect knowledge assumption in mainstream theory, that assumption renders such theory, when used to explain the equilibrative properties of markets, internally contradictory and incoherent."[225] In his pioneering work *Information and Investment* Richardson had

223 Kirzner, How Markets Work, p. 23. Interestingly, by 1940, Clark had already pointed out: "[The standard of perfect competition] has seemed at times to lead to undesirable results, in that it does not afford reliable guidance to the factors which are favourable to the closest available working approximation to that ideal, under actual conditions". (J. M. Clark, "Toward a Concept of Workable Competition", 30 The American Economic Review, [1940] at 241)

224 Ironically, Thomsen argues the flaws of conventional analysis: "this approach has some unavoidable contradictions, because to make such decisions correctly –as must be the case in equilibrium– agents must know beforehand what they are ignorant of and the costs and benefits of the knowledge they could acquire; that is, they must know what it is they do not know." (E. Thomsen, Prices and Knowledge, (London: Routledge, 1992), p. 23.)

225 Kirzner, How Markets Work, p. 23.

already emphasised how the premises which prevail under perfect competition are indeed inconsistent with the conditions that should prevail in order to reach such a state.[226]

In conclusion, antitrust principles rest on a misguided appraisal of reality, which is a consequence of applying a methodology unsuitable for evaluating human relations wihin the market.

1.2.- Divergence between the objectivism of conventional regulatory appraisal and the subjective essence of real markets.

Contrary to neo-classical assumptions, individuals seldom possess sufficient information about the conditions that could influence their economic behaviour. This is a fact that runs counter to the omniscience that neo-classical analysis assumes of market participants. In the realm of antitrust policy, this information is assumed to be transmitted to a central "antitrust" agency, which will then establish whether a given undertaking falls short of achieving some standard of social allocative efficiency.

It is clear, however, that this is not the case. Individuals live in a "fog of ignorance" that leads them to speculate about how future circumstances would affect their businesses. At most, they seek to grasp certain trends in the hope that these will lead to certain future outcomes, but nobody ever knows for sure because their knowledge is fragmented. Hayek observed: "The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess".[227]

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226 See generally G. B. Richardson, Information and Investment (Oxford: Oxford University Press, 1960.)

227 F. A. Hayek, "The Use of Knowledge in Society", in Individualism and Economic Order, (Chicago: The University of Chicago Press, 1948), p. 77.

Individuals face difficulties in assessing what information other participants hold, because of its subjective nature. In this regard, knowledge is subjective in nature in the sense that it relates to the expectations of individuals rather than objective data. As Loasby has indicated, "choices depend upon beliefs": individuals overcome their "misbeliefs" by interacting with each other and by adjusting their initial expectations through a process of "trial-and-error".228 Markets arise from subjective valuations by individuals who either choose to buy or sell, or alternatively refrain from doing so. For example, consumers act upon their perceptions of which commodities are available and the prices they must bid to secure them. To make the optimal choice of commodity price, they must discover the whole range of prices and commodities available to begin with. As discoveries are made concerning hitherto overlooked commodities and unsuspected price opportunities, the array of buyers' bids is progressively modified.

As an individual, no entrepreneur can know the actions of the others; therefore, his actions are nothing more than a tentative inquiry into an uncertain future. Entrepreneurs are forced to seek and obtain *enough* information to encourage them to make investments *today*, which are related to *future* production outputs. Information may not be complete, but nevertheless it accomplishes the aim of enabling investments to be made.

It would be presumptuous to assume that all the information relevant to one investment can be acquired. Because of its subjective nature, uncertainty is endogenous vis-à-vis economic interaction in the sense that it cannot be erradicated from real life. There is no way that individuals can foresee the future from their knowledge of present circumstances. Additional information may eliminate "initial" uncertainty, but still creates more in the future. As O' Driscoll and Rizzo contend, "further information has not eliminated uncertainty, but has merely transformed it to a higher level of counterguessing".229

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228 B. Loasby, The Working of a Competitive Economy: G. B. Richardson's post-Marshallian Analysis in "The Mind and Method of the Economist" (Aldershot: Edward Elgar, 1989), p 87; see also, O'Driscoll and Rizzo, pp 37-38.

229 O'Driscoll and Rizzo, at 73.

There are two reasons for this. Firstly, because individuals attempt to outdo everyone else in the market, they will be inclined to seek information that either gives them an advantage or prevents others from gaining one. Individuals will tend to appropriate information, and will not therefore be inclined to transmit it into the system. Secondly, (and this is crucial) because individuals do not make predictions about objective data (such as the availability of resources) thus in their co-ordination of activities, but rather try to conjecture *what other individuals are predicting*. Their knowledge of the world, hence their behaviour, will be influenced by the beliefs of other individuals. Social knowledge is thus construed on the basis of mutual expectations, which as Keynes demonstrated in his "Beauty Contest case", is a precondition of *sheer uncertainty*.230

For this reason, these expectations exclude decisions resulting from routines or conventions, because the need to obtain information does not arise. Thus, expectations are not formed unilaterally; they require speculation by all concerned. It is an exercise of guessing what everyone else is guessing. A mere insight into the habits of other producers is insufficient to ensure an appropriate level of commitment from everyone else. As

230 This case exemplifies the "genuine" uncertainty surrounding decisions taken on the basis of mere expectations. The speculative nature of the decisions market participants adopt in their transactions is similar to a beauty contest whose winner is chosen according to the reciprocal expectations of the deciding judges. In Keynes's example, each judge casts his vote according to what he considers other members of the jury will decide, but since none of the judges possess certainty as to the decisions of the rest, as he does not possess an objective fact on which to base his decision. All their decisions will inevitably be based on sheer or genuine uncertainty (See, Keynes, J. M., The General Theory of Employment, Interest and Money, (New York: Harcourt, Brace & World, (1964) [1936]), p. 156. To understand how sheer uncertainty prevents markets from functioning, unless certain devices are brought into action, consider the case of a firm aware that the total demand for a product will rise by a certain amount at a future time. Other competitors are equally ready to seize the profit opportunity. Therefore, it is impossible for our particular entrepreneur to form a reliable expectation of what the volume of competitive supply is, and what the future price of the good will be. In the event of sheer uncertainty, any decision to stop guessing is either arbitrarily chosen by a superior authority, or decided by agreement among market participants. As O'Driscoll and Rizzo argue: "There is in principle no limit to the height of the levels of guessing and counter guessing. There is no *logically sufficient* reason to stop at any point; all such stopping is, to a large extent, arbitrary or derived from a convention". (See, O'Driscoll and Rizzo, p. 73). In the case of market transactions, these conventions sometimes occur in the form of explicit co-operation through manifold arrangements, or by tacit understanding where one firm appraises those elements that shape its expectations about other firms: reputation, previous business behaviour, and so on. We shall return to this question more extensively below.

O'Driscoll and Rizzo argue, acquisition of knowledge is primarily responsible for its continued existence.231

Another crucial factor in the consideration of the emergence of business expectations is that they are in constant flux, as individuals' perspectives of the system continuously change. As time passes, individuals' predictions about future outcomes change too, affecting the information obtained by others.

In forecasting the future, individuals must constantly redefine their initial plans as they discover in retrospect that they are unsuited to their present goals. Time reference under this dynamic horizon is therefore evolving in the sense attached to it by Henri Bergson, la *durée reel* or "real time", or "the continuing flow of experiences".232 The notion of "real time", like that of subjective knowledge, is essential in the differentiation of institutional analysis from neo-classical. Neo-classical analysis relies on Newtonian time, which is "spatialised"; "its passage is represented or symbolized by 'movements' along a line".233 By contrast, "real time" emphasises the *subjective* experience of the passage of time which conditions "human action". It is a "dynamically continuous flow of novel experiences". Subjective time is "continuously dynamic" (the present is linked to past memory and to future expectation), "heterogeneous" (each moment is different and novel), and has "causal efficacy" (time as a source of novelty). In real markets, individuals interact under conditions of subjective time: action does not take place in a single moment, but in a continuum of flowing moments.234

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231 O'Driscoll and Rizzo, p. 74.

232 H. Bergson, Time and Free Will: An Essay on the Immediate Data of Consciousness. (London: George Allen Unwin, 1910.)

233 O'Driscoll and Rizzo, p. 53. According to these authors, in this form of time different dates are portrayed as a succession of line segments or points within which decision making is done. Therefore, it is "homogenoeus" (each point is identical to all others), it is "continuously divisible" (no matter how finely we divide time and how close the resultant points are to each other, there is always some space between them) and it is causally inert (if there are changes, these must be computed from the beginning. The initial stage contains all that is necessary to produce "change": passing time adds nothing).

234 In general, see L. Lachmann, "Professor Shackle on the Economic Significance of Time" in Capital, Expectations and the Market Process: Essays on the Theory of the Market Economy. Institute for Humane Studies (Kansas City: Sheed Andrews and McMeel, Inc., 1977), pp. 81-93; also, O' Driscoll and Rizzo, pp. 52-70. Also, M. Rizzo, Real Time and Relative Indeterminancy

Thus, business expectations constitute the core of decisions adopted under uncertain conditions. They provide entrepreneurs with a tentative insight into the future. Taylor explains how real time affects economic calculations: "There is no precision in economic calculation because of the uncertain future that pervades all activities in the market economy. Predicted future costs and revenues are an expectation of the entrepreneur producer, who possesses no superhuman ability to know the future. This uncertainty similarly affects the retrospective calculation of profit and loss because the most recent calculation of capital is tenuously based on a money equivalence that the future may not uphold. An individual decision-maker is unable to know precisely the future preferences of consumers, changes in technology, plans and actions of other producers, and the infinite number of other external events that will occur in the future. The gathering of empirical data as is done for actuarial tables is not sufficient for the purposes of entrepreneurial activity in the market economy".235

It is this *changing and evolving* exercise of forecasting which gives the analysis its distinctive subjective flavour. As Mises indicates, uncertainty about the future is inseparable from human action. If individuals knew their future, they would not need to choose and therefore would not need to act. They would simply become machines reacting to external stimuli without any sense of purpose.236 Moreover, as Buchanan and Vanberg say: "At the core of (the) attack on the 'neo-classical citadel', and central to the radical subjectivist view in general, is the issue of what we can claim to know about the future in our efforts to understand the world of human affairs. The basic objection to neo-classical general equilibrium theory is that it embodies assumptions about the possibility

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in Economic Theory, New York University, paper presented at the Austrian Economics Colloquium, Department of Economics, New York University, November 1996.

235 C. Taylor, The Fundamental of Austrian Economics, (London: Adam Smith Institute, 1980), p. 19. Sheer uncertainty, which characterises entrepreneurial forecasting activities should be differentiated from mere risk; whereas the former cannot be assessed, the latter may be measured with actuarial calculation. Frank Knight was the first to distinguish between the two notions. See F. Knight, Risk, Uncertainty and Profit, Reprints of Economics Classic, (New York: Sentry Press, (1921) 1964.

236 L. Mises, Human Action: A Treatise on Economics, (London: William Hodge and Co. Ltd., 1949); pp. 105-106.

of knowing the future that are entirely unfounded, not only in their most extreme variant, the assumption of perfect knowledge."237 Sheer uncertainty is a crucial challenge to neo-classical models.

Individuals must assess the constant flow of new information arising from their exchanges, leading them to change their initial plans in order to adapt their needs to the new objectives which arise. In this way, the open-ended nature of information prevents the social system from achieving neo-classical "equilibrium".

Mainstream models do not enable a proper appraisal of market relations, because they treat information as a "given" objective asset. Even SCP "dynamic" models depicting business strategic behaviour fall into this false assumption. Thus, it makes no difference that these models emphasise the problem of co-ordinating individuals who are acting strategically (in order to recreate a dynamic business setting); they fail to do so because they do not address the same problems of co-ordination that individuals face in reality. Indeed, mainstream economics suppresses this problem entirely by assuming: a) that there is an isomorphism between the real world and the market player's image of it; b) that market players only differ with respect to decision-making capabilities in terms of how fine or coarse their information partitions are; and c) that information partitions are given, just like full information is given in the general equilibrium model, and that sheer uncertainty resulting from mistakes and surprises, producing genuine knowledge gaps, can be ruled out.238 Foss concludes that, "in much of game theory there is precisely the conflation between the objectively existing and subjectively perceived (reality)", but that, "the co-ordination problem of course isn't solved at all, merely side-stepped."239 The comparison to be made is not between static and dynamic equilibrium, but between equilibrium and disequilibrium as heuristic models of interpreting reality.

237 J. Buchanan and V. J. Vanberg, "The Market as a Creative Process", Economics and Philosophy, vol. 7 (1991), pp. 167-186.

238 N. Foss, Firms and the Coordination of Knowledge: some Austrian Insights. DRUID Working Paper No. 98-19, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1998, p. 17.

239 Foss, Id., p. 18.

Contrary to the neo-classical paradigm, which implicitly assumes the omniscience of the decision-maker by considering this knowledge to be an asset which is objectively appraised, the nature of this information is not only to be scattered but also subjectively appraised. As Thomsen contends: "[In the neo-classical equilibrium framework] knowledge is treated as a costly commodity that, like all other commodities, must be economized. Therefore, the resulting equilibria entail not perfect but only optimal knowledge: agents will have deliberately uneradicated ignorance. Such ignorance remains uneradicated because the benefits of additional information do not compensate for the costs of acquiring it".[240] Knowledge is fragmented and appraised by each individual within his own framework of means-ends, and consequently, evolves on a continous basis.

In fact, as a commodity this "knowledge" may well be information that no individual in the economy has yet, since in an evolving world (i.e. disequilibrium), individuals are forced to deal with new problems for which they must devise new solutions. These new ways of solving unexpected problems require new understandings and perceptions of social phenomena. This enables a "discovery of facts", in Hayekian terms, which is the goal of any economic system: "[The economic problem] is not merely a task of utilizing information about particular concrete facts which the individuals already possess, but one of using their abilities to discover such facts as will be relevant to their purposes in the particular situation."[241]

1.3.- Consequences of antitrust policies objectivism on legal analysis.

Perhaps the limitations of the conventional approach are best illustrated by the inability of antitrust decisions to produce a stable rule of law that distinguishes between "pro-competitive" and "anti-competitive" restrictive trade arrangements. For this reason, decisions taken in the execution of this policy cannot be subject to justiciability by courts.

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240 E. Thomsen, Prices and Knowledge, (London: Routledge, 1992), p. 23.

241 F. A. Hayek, Law, Legislation and Liberty The Political Order of a Free People, p. 190.

as this section will show.

To examine the nature and scope of this problem, it is useful to refer to the enhanced enforcement discretion which results from a positivistic understanding of legal theory and economics in this field. This economic theories can be incorporated into the body of law, defined as a set of "blind orders" dictated by an authority. Finally, we will examine more closely the rule-of-reason analysis currently used in antitrust enforcement, to highlight the impossibility of distinguishing between "good" and "bad" market arrangements.

There is an implicit assumption in antitrust legal analysis that economic data can be appraised objectively, as "facts" are capable of being appraised in legal cases. From this objective data, antitrust theory discerns the intention of agents that enter into market arrangements, which is an essential condition for establishing whether they are acting monopolistically. Antitrust legal analysis simply endorses whatever ready-made normative conclusions are deduced about the inner intentions of entrepreneurs, in order to impose penalties. The crucial question, then, is whether neo-classical economic theory can provide such a distinction.

The answer is negative: facts, as we have seen, cannot be objectively appraised because they are devoid of the subjective values shared by the observer just as much as by market participants. There can be no single conclusion about the intentions of parties undertaking restrictive arrangements, which must be explained in relation to what each party perceives to be desirable, not to what an external observer assumes society wants.

The conventional paradigm is incapable of pointing to unique or single explanations about the causality of economic data. Its flaws are clearly seen in the predictive nature of its models (a feature no doubt inherited from its positivistic background), which encourages as many explanations as there are tentative hypotheses to explain such causality. In other words, there are not one but many competing theories *explaining* the causality attached to these "facts". As Brenner points out, "there is not one model, not one argument in economic theory, which –when taking into account entrepreneurship, innovations and chance– would relate structure to performance and anticompetitive conduct, and which, in particular, would suggest viewing with suspicion even a persistent positive correlation between 'profits' and concentration".[242]

Further, since legal rules are instrumental in this approach, it is easy to foresee that several diverging, even conflicting, legal rules will emerge, each one representing a particular decision of the authority in question issued in accordance with each hypothesis. Loughlin criticises analysts who have attempted to make objective legal determinations. In his opinion, philosophers of science have undertaken the futile task of defining a single set of criteria as a basis for differentiating objective from subjective knowledge. However, as Bernstein states, "the lesson to be learned, rather, is how difficult and complex it is to articulate standards of objectivity relevant to different domains of inquiry, and the ways these standards are open to criticism."[243]

As indicated above, all neo-classical efforts to appraise market relations objectively are futile, at least in the uncertain and changing context which the entrepreneur faces in his activities. Rather than building up reliable legal principles on which to enforce a rule of law that would promote competition, economic analysis in its neo-classical versions provides an array of competing theories, none of which is stable enough to render policy enforcement predictable.

The contradictions in antitrust legal doctrines, which have evolved over time in successive legal rules, have mirrored this proliferation of conflicting models. These doctrines are found in the text of statutes, regulations, legal decisions, administrative rulings, and general legal rules enacted in this field.

Many market arrangements now presumed "fair" were formerly considered to be monopolistic manipulations of trade. Resale price maintenance, for instance, used to be

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242 R. Brenner, 'Market Power: Innovations and Antitrust', in The Law and Economics of Competition Policy, F. Mathewson et al. (eds.), (Vancouver: The Fraser Institute, 1990), p. 196.

243 Bernstein, Op. cit.

considered prohibited *per se*, as it was seen as disguised horizontal price-fixing among retailers; however, today it is viewed under the more flexible "rule-of-reason". Similarly, there are still echoes of the most famous "successful" antitrust prosecution ever. The conclusions of the Alcoa case decided in the late 1940s appear unsatisfactory today.[244]

In fact, the ambiguities associated with the functioning of the rule-of-reason are inherent in the historical evolution of antitrust policy. This can be seen, for instance, in the difficulty of defining terms like "lessening competition", "unfair restrictions" and the like under successive U.S. antitrust statutes[245] and in the difficulty of developing

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244 In this regard, Bork makes an extensive critique of landmark antitrust cases, which guided policy enforcement for decades. See R. Bork, The Antitrust Paradox. Some of these cases are compiled in W. Breit and K. Elzinga, The Antitrust Casebook: Milestones in Economic Regulation, (New York: The Dryden Press, 1982).

245 M. Handler, Antitrust in Perspective, Columbia University Press, New York, 1957. Handler gives us a good example of this in the long history of failed attempts (still present) of the U.S. Congress to determine the scope of the rule-of-reason initially formulated under the Standard Oil and the Addyston Pipe cases. Once a rule-of-reason was introduced, discretion to decide good trusts from bad ones emerged. Almost immediately, the rule-of-reason was open to criticism because "a rule of discretion without objective limits invited the court to 'set sail on a sea of doubt', and to exercise 'the power to say (...) how much restraint of competition is in the public interest, and how much is not" (Addyston Pipe & Steel Co. , 85 Fed. 271, 283-284. [6th. Cir. 1898] aff'd, 175 U.S. 211 [1899].) Henceforth, all legislative efforts to clarify the distinction between monopolistic and non-monopolistic restrictions inevitably failed because they could only provide clarity at the expense of prohibiting many useful business undertakings. Nevertheless, this is the approach that President Wilson advocated to challenge protests against the ambiguities of antitrust policy. In his 1914 message to Congress, he requested "a further and more explicit legislative definition of the policy and meaning of existing antitrust laws", in particular, an "item by item" statutory prohibition "in terms as will practically eliminate uncertainty" (President Wilson's speech, quoted by Handler, p. 30.) The outcome was the Federal Trade Commission Act and the Clayton Act of 1914. These statutes, however, did not set absolute prohibitions; their provisions required a tendency to monopolise or a substantial lessening of competition. Neither dealt with the problems created by the rule-of-reason. As a consequence, the 1914 legislation left antitrust in this state: the creative role of the judiciary under the little-understood and much maligned rule-of-reason, far from being curtailed, was supplemented by a blank-check grant of power to a new administrative body whose outlawing of 'unfair methods of competition' was made subject to judicial review. Therefore, the legality of business techniques which were conditionally forbidden was to be governed by a new statutory yardstick ('substantive lessening of competition'). The problem of engrafting and clarifying a judge-made rule-of-reason was obviated by the fact that the statute contained a built-in qualification. This qualification, however, did not essentially differ from the rule-of-reason. As Handler puts it: "...precisely how this new test differed, if at all, from the criticised but unrejected judicial criteria, neither its words nor history disclose". (p. 31.) In fact, the inclusion of the term "substantially" did not add anything new to the test. Handler states: "Congress appeared to be re-enacting the same 'direct-indirect' standards and investing the courts with the same discretion that the new legislation was supposed to forestall". (footnote 16, p. 115.) As a result, an administrative or judicial tribunal would have to determine in each case whether the challenged practice was likely to substantially lessen competition. "In essence, [the US] Congress with a minimum of guidance returned the problem of antitrust to the courts whose

predictable legal standards to provide a proper measure against which to appraise individual cases in the European Union.246

In Latin America, the problems of making such distinctions have also been noted: "(...) the lack of criteria to distinguish between per se and rule-of-reason behaviour (...) makes law enforcement very hard and only leads to increase confusion unnecessarily in a country with no antitrust tradition".247

Accordingly, pleading before antitrust agencies is an art of persuasion based on giving the "best" or most convincing hypothetical causal explanation (i.e. theory) to connect otherwise isolated events. This is clearly illustrated in the kind of evidence gathered in antitrust proceedings. The information collected to determine the liability of a firm in undertaking a particular arrangement comprises, for example, statistics, information about the industry concerned, information about the performance of similar industries in other countries, as well as the opinion of witnesses on trends in the industry.248 In other words, evidence on all sorts of economic factors relating to the business environment, but no evidence about the undertaking *itself*. Thus, evidence comprising statistics about the economic behaviour of similar firms in the past, or in other markets, or the testimony of witnesses about their opinion of the likely behavior of the industry is used to demonstrate the likelihood of the hypothetical conclusions of the economic theory used by the authority in question. Stevens and Yamey once complained that the old UK Restrictive Practices Court "has not often had the benefit of accounts of

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prior solutions had aroused so much dissatisfaction". (p. 31.)

246 Korah has raised this point emphatically by criticising the failure of the European Union Competition Agency, the DG IV, to determine *ex-ante facto* what practices impede competition, which would provide some criteria on which enterprises could determine their legal status vis-à-vis competition issues in advance. (Korah, pp. 267-284.)

247 A. Jatar, Políticas de Competencia en Economías Recientemente Liberalizadas: El Caso de Venezuela, internal paper, Superintendencia Pro-Competencia, Caracas, 1993, p. 14. Jatar does not realise that such a distinction is impossible, no matter how detailed the regulation may be, because the instability of economic theory prevents it from identifying either behaviour; and not, as she alleges, because of the lack of legal distinctions.

248 R. B. Stevens and B. S. Yamey, The Restrictive Practices Court: a Study of the Judicial Process and Economic Policy, Weidenfeld and Nicolson, London, 1965, pp. 91 et seq.

events in actual situations closely similar to the hypothetical situations with which it has been concerned when predicting the effects of the termination of restrictions".[249]

Indeed, antitrust theory is linked to hypothetical conclusions about market behaviour. For example, a crucial element in considering the existence of *monopolistic* intentions in a given undertaking is to determine whether the firm enjoys market power. However, we cannot perceive *market power* through our senses; instead our hypotheses tell us about its existence and we construct a hypothesis to predict its implications.

Consider the current lines of reasoning in any antitrust proceeding. All parties are tempted to interpret the observed facts in their favour, showing that their respective theory is *the correct one*. Plaintiffs (either private parties or administrative agencies) will endeavour to show that concentration is *high enough to assume* that market power exists, whereas defendants will aim to show that market power does not exist, either because concentration is low, or because *a correct economic interpretation of facts shows* that regardless of concentration, firms cannot exercise market power. However, if facts are perceived and understood in terms of the endorsed theory, it is obvious that there is no way to get around this deadlock, and that any attempt to construct an "objective" interpretation is doomed to failure.

In practice, this impossibility leads to several complications in the analysis of market restrictions under antitrust proceedings. For example, why should we regard some types of data as valid for the purposes of formulating our assumptions about the restrictive behaviour of firms, and exclude other data? Neo-classical economists assure us that this is achieved by examining the cross-elasticity of demand, which will tell us how willingly consumers are to substitute one product for another. This has led reputed scholars like Robert Bork to make dubious statements such as: "While no clear cut lines can be given [as to which firms enjoy market power] one useful cut-off is that ninety percent of the market share is usually high enough, while a 60 percent share is often too

249 Stevens and Yamey, p. 112.

low".[250] Yet when it comes to determining the size of a given market, *why* should we exclude some products from it and leave others?

It is fair to say, however, that Bork's opinion is not shared by all antitrust advocates, who acknowledge the difficulty of ascertaining a 'magic number'. For example, Khemani and Dutz contend: "To determine the existence of dominance, different countries specify different market-share thresholds. There is no critical market share of concentration level that clearly signals the degree of competition and monopoly in a market. Moreover, there is disagreement about how to delineate the relevant size of a market".[251]

Neo-classical premises of objectivity conflict with the subjective nature of information conveyed by the market. From this alternative perspective economic data would render a different appraisal of the phenomena observed. For example, there would be an alternative explanation of market concentration to the one provided by neo-classical appraisal. In this respect, Sowell states: "The alternative explanation about market concentration is that some industries are concentrated because some firms' products are simply preferred by consumers, either because of their quality, price, convenience or other appeal. If this is true, then the slightly greater profitability of industries with few sellers is not because the whole industry is more profitable (as it would be under collusion), but because some particular firms have a higher profit rate which arithmetically brings up the average, while economically [this] does not make the rest of the industry any more profitable than under competitive conditions. The data in fact show no profit advantage to a firm of a given size in being in a concentrated versus a non-concentrated industry."[252]

Consider a variable such as price, which is generally used in antitrust proceedings as the yardstick for appraising whether a monopolistic intention exists behind a particular

250 Bork, p. 166.

251 Khemani and Dutz, p. 24.

252 Sowell, p. 206.

arrangement. What does price *really* tell us? Does it tell us some sort of objective information, which can be contrasted with costs? In a subjective appraisal it certainly does not. Ebeling explains why: "A seller finds himself with the unsold inventory of a product in excess of desired levels at a particular price. But what exactly is the market telling him at that price? That he needs to relocate his store? That he has failed to advertise the existence or availability of the product sufficiently? That the price is 'right' but the quality or characteristics of the product is 'wrong'? Or that the quality and characteristics are 'right' but the price is 'wrong'? What the price has conveyed is information that something is wrong, that the seller's plans and expectations are inconsistent with those of others. It has not unambiguously told him in which direction the error lies. The price information, in other words, needs interpretation as to its meaning concerning the preferences and plans of others."253 Again, values and goals are necessary to give prices some meaning in the context of the transaction.

There is no such thing as objective empirical evidence which is able to support a positive determination between monopolistic and non-monopolistic market behaviour. For instance, costs cannot be appraised independently of the concerns of investors who have had to forego an alternative course of action (opportunity costs). The attempt to find an objective marginal cost against which to measure the efficiency of a given undertaking, in order to determine "monopolistic" social costs, is a mere delusion. Costs cannot be appraised from market prices; prices result from competing valuations which are expressed in the costs that market participants have to tolerate in their economic activity.254 Lavoie contends: "The MC = P rule will optimize allocation within a given

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253 R. Ebeling, "Towards a Hermeneutical Economics: Expectations, Prices and the Role of Interpretations in a Theory of the Market Process", in Individuals, Institutions, Interpretations. Hermeneutics Applied to Economics, D. Prychitko (ed.), Avenbury, Aldershot, 1995, p. 143.

254 There is important economic literature about the subjectivity of costs. See in particular J. Wiseman, "Uncertainty, Costs and Collectivist Economic Planning", in L.S.E. Essays on Cost, J. Buchanan and G. Thirlby (eds.), (New York: New York Unversity Press, 1981). In the same volume, Thirlby argues that every rule establishing the existence of an ascertainable objective relationship between income and costs (that marginal revenue equals marginal cost or price equals marginal cost or total revenues equal total costs) "has not the objectivity that is by implication attributed to it; consequently, the application of the rule is impracticable". (Thirlby, "The Ruler", p. 166.) Also Huerta de Soto: "The marginal cost rule cannot be used because costs do not determine prices, but quite the opposite, it is prices that determine costs; therefore, the rule possesses all the ambiguity of a circular reasoning". (See Huerta de Soto, p. 325.)

framework of means and ends as long as future costs are expected to be the same as current costs. This is a world of static expectations, which are reasonable in a static world. In a world of continuous change, however, an entrepreneur must try to anticipate demand, to form expectations, and to act on them. He should view his costs on the basis of the specific alternatives that appear available to him at the time of his choice. Both his estimate of revenue and his estimate of costs depend on his expectations at the time of decision".255

For instance, there is no objective measure to establish that, one corporate form or market arrangement is socially "better" or "more efficient" than another. Such a determination ultimately rests with those subjective costs (i.e. opportunity costs) perceived by market participants.256 Nor is there a magical number telling us objectively that a firm belongs to one particular market or another. Antitrust agencies cannot set a degree of concentration beyond which it is inferred that firms are behaving monopolistically. In this regard, Areeda writes: "There is no concentration number above which anti-competitive pricing is clearly threatened and below which competition is clearly assured".257 In the end, regardless of the technical complexity surrounding the discussion, the matter is left to arbitrary choices which are devoid of any analytical consistency. Antitrust legal doctrines are presented and supported by mere allegations; not by objective facts. Thus, no positive conclusion about monopolisation can be made from the fact that a firm possesses, say, over ninety per cent of the relevant market, unless the observer assumes that such concentration encourages firms to undertake monopolistic endeavours. For this reason, Sowell concludes: "what is involved here is not a technicality of antitrust law, but a far broader question about the use of knowledge and

255 D. Lavoie, Rivalry and Central Planning: The socialist calculation debate reconsidered. (New York: Cambridge University Press, 1985), p. 141

256 Rothbard, "Monopoly...". Nevertheless, conventional economic theory leads antitrust authorities to focus their attention on "objective" evidence such as the size of the factory and market share, the intensity of competition resulting from marketing and advertising strategies, and the scope of channels of distribution. Obviously, in a closed-end appraisal of markets no other conclusion could follow from these elements except that they enable entrepreneurs to exploit artificially high levels of profitability.

257 P. Areeda, "Monopolization, Mergers and Markets: A Century Past and Future", 75 California Law Review, [1987], p. 977.

the role of articulation. The basic problem in these definition-of-product issues is that substitutability is ultimately subjective and prospective, while attempts to define it must be objective and retrospective."[258]

Hence, antitrust economic theory transforms circumstantial evidence into full evidence by linking these otherwise isolated facts into an elaborate chain of suppositions and predictions. Ultimately, determining antitrust legal liability is not a matter of putting forward objective factual evidence in support of one's contention, it is speculative inquiry (theory) to create a presumption of guilt which, if not challenged, results in legal liabilities for firms participating in the arrangements. However, as Sowell graphically puts it: "There is usually nothing in antitrust cases comparable to finding someone standing over the corpse with a smoking pistol in his hand. Objective statistical data abound, but its interpretation depends crucially on the definitions and theories used to infer the nature of the prospective process which left behind that particular residue of retrospective numbers."[259] Therefore, the identification of truly monopolistic undertakings in order to impose legal liability is dependent upon an impossible condition, namely, that of making objective appraisals about collected data.

In short, antitrust agencies reach conclusions about the existence of violations of the *public interest* based on evidence that does not relate to the conduct of the firm investigated, but is based on data explaining the conduct of anonymous market forces. The relevance of these forces to the legal action can only be determined through the causal link offered by the particular theory endorsed by the antitrust authority. The definition of legal liability in this case is therefore subject to the evidence of guilt that these theoretical hypotheses, predictions and suppositions provide.

Antitrust agencies overlook the fact that economic theories are mere predictions about the future; pure speculation about uncertain facts, which may or may not occur. They cannot therefore serve as a basis for the imposition of legal liability. It is not

258 Sowell, p. 204.

259 Sowell, p. 203.

surprising, then, that there is an irresistible temptation for the agencies to make arbitrary interpretations of these "objective" facts about the arrangement under investigation, which confirm their own theories.

In conclusion, because of its subjective nature, economic data cannot serve as evidence of regular and predictable *objective* patterns of behaviour in the market. The attempt to make objective appraisals about the intentions implicit in the actions of market actors is impossible outside the realm of closed-end systems, where all information is known (i.e. assumed). As we demonstrated in the previous section, this is supported by the failure to formulate theories that offer satisfactory explanations about market behaviour.

2.- THE IMPOSSIBILITY OF THE CONVENTIONAL REGULATORY APPRAISAL FOR IMPLEMENTING PREDICTABLE SOCIAL WELFARE GOALS.

Although tempting, the idea of achieving social welfare goals through purposeful regulation has two severe flaws: the first is the practical impossibility of achieving public goals with the aid of instruments which call into question their *raison d'etre*. The second one refers to the undermining effect on individuals' rights within the market. Both considerations affect the ultimate plausibility of those institutions governing market transactions, which are embodied in the rule of law.

Our basic contention is that conventional regulatory appraisal entails cost-benefit calculations that can only be made with reference to social welfare standards whose appraisal through practical enforcement is too expensive in terms of the informational requirements it posits on the enforcement authority. A point is reached where the standard itself becomes "non-optimal" and therefore, impossible to achieve. This is even clearer if the passing of time is considered in the analysis. In light of these difficulties, the authority will have no more choices but to follow "ad-hoc" welfare standards in its enforcement activity. In this way, any policy enforcement decision becomes entirely unaccountable by conventional legal instruments, and the rule of law erodes.

2.1.- The futility of comparing reality with idealised standards for policy enforcement purposes.

The idea of achieving optimal social welfare in an "imperfect" world is a self-defeating one for policy purposes. Public policy is neither conceived nor implemented in the abstract: it is intended to produce effects on real markets and people. However, finding a "social optimum" in the real world is, by necessity, denied since no policy-maker has the perfect information to know with certainty when or where social welfare will actually be maximised following intervention. It is impossible to determine whether equilibrium has been achieved.

Any attempt to deduce an "optimal" point from the mere observation of the number of firms existing in a market is simply a delusion, since the authority cannot possess sufficient information to establish the "right" number of firms that should prevail in the market. In other words, conventional welfare analysis disregards the costs of achieving such an optimal state. The costs stem from the subjective nature of the information that has to be passed on to the planning authority in order to achieve social welfare.

As we have indicated, market information is "subjective, practical, disperse and hardly articulable".[260] In other words, it is information which will always be inaccessible to the external observer due to its subjective nature. It is subjective, in the sense that it can only be appraised under the influence of those according to the individual means, goals, needs and objectives held by whoever possesses it for enhancing his or her own well being. Thus, it can only be properly appraised by market participants and cannot be passed on even to a neighbour, much less to a distant planning or antitrust authority.[261]

260 J. Huerta de Soto, La Methodenstreit, o el Enfoque Austríaco Frente al Enfoque Neoclásico en la Ciencia Económica, actas del 5o. Congreso de Economía Regional de Castilla y León, Avila, 28-30 November 1996, p. 53.

261 For an extensive analysis of the problem of knowledge or subjective information, see in general O'Driscoll and Rizzo, pp. 35-51, 71-91. Also, Huerta de Soto, Socialismo... pp. 41-86. Also, J. Huerta de Soto, "Entrepreneurship and the Economic Analysis of Socialism", in New Perspectives on Austrian Economics, G. Meijer (ed.) (London: Routledge, London, 1995), pp. 228-253. Even assuming that it would be possible to appraise economic information objectively, Sen has noted that individuals would not have the incentives to reveal to the authority the information necessary to make such decisions, because choosing among equally efficient

These troubles are clearly expressed in the so-called "Second Best Problem". Social efficiency requires not one, but all markets to be in a state of equilibrium. Yet there no guarantees that achieving efficiency in one market will improve the efficiency of the system as a whole. As Veljanovski argues, "in an imperfect world where some sectors of the economy persistently deviate from efficiency, it will no longer be true that fostering efficiency in other sectors will maximize economic efficiency. The constraint imposed by deviant sectors of the economy must be taken into consideration and this will require immensely complex, if not impossible, calculations to determine the optimal policy."[262]

Moreover, finding social welfare gets more complicated if one considers the passage of time, which is inherent within the functioning of real markets. In a changing setting, individuals constantly reconsider their goals on the basis of new experiences; this information, which could enable the identification of a social optimum, is in continuous flux and cannot be assessed objectively. It is neglected under static analysis, which does not consider the effect of time in evaluating government intervention. As Boettke argues, "In cases (...) where discretionary intervention might be desired to correct for perceived market failures, the problem remains as to how to acquire the requisite knowledge to intervene properly. Ignorant or haphazard intervention will simply lead to further destabilization and exacerbate the problem it sought originally to correct".[263] The

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solutions inevitably turns the matter into one of deciding on the basis of distribution concerns. (Sen, pp. 36-37.) Even if individuals were successfully compelled to disclose their information and the necessary lump-sum transfers were identifiable and economically feasible, "issues of political feasibility can be, obviously, extremely important when dealing with such fundamental matters as the radical changes in ownership". (Sen, p. 37). On the question of the political interaction induced by antitrust enforcement, see in general F. McChesney and W. Shughart (eds.), The Causes and Consequences of Antitrust: The Public-Choice Perspective, The University of Chicago Press, Chicago, 1995.

262 Veljanovski, The New Law-and-Economics, at 21. This is what the economic literature currently refers to as the "second-best problem".

263 P. Boettke, Why Perestroika Failed: The Politics and Economics of Socialist Transformation, (London: Routledge, 1993), p. 92. Antitrust agencies have serious limitations in adopting efficient measures which correct perceived breakdowns in the system due to the passage of time. This is a problem which is not related to antitrust policy exclusively but to conventional policy-making in general. As Boettke argues: "The dynamics of change associated with the passage of time also present a timing problem for public policy, as Milton Friedman pointed out a long time ago. A long and variable lag exists between: (1) the need for action and the recognition of this need, (2) the recognition of a problem and the design and implementation of a policy response

uncertainty which emerges is ever-present in the process of action and reaction, whereby individuals adopt business decisions, subject to the constraints of legal environments, that give considerable powers of intervention to government agencies. The result of this process is that governments cannot adopt efficient regulations because of their informational limitations, and individuals cannot predict the conduct of governments *over time*. As Cordato observes: "the extent to which the real world resembles a static (i.e. timeless) Pareto optimum cannot be a meaningful measure of performance for actual market processes."264

The implication is that "even if Perfect Competition General Equilibrium and therefore Pareto optimal market outcomes could be identified for a point in time (...) they would immediately become obsolete as soon as time is allowed to pass".265 For this reason, "the problem of constructing an optimal governmental policy that intervenes properly without distorting the flow of information is compounded by the passage of time. For one, relevant economic data is contextual and not abstract. Information gathered yesterday may be irrelevant for decisions today because of changing conditions. The price system overcomes this problem by alerting individuals to these changes through the adjustment of relative prices. Activity outside the context of the market, however, does not have access to such a register of accommodating changes in intertemporal decisions".266

and (3) the implementation of the policy and the effect of the policy. Because of these lags, Friedman argued that discretionary public policy will often be destabilizing. For this reason he argued the case for rules rather than discretionary public policy". More specifically, "the passage of time introduces strategic problems for policy-makers. Policies that seemed appropriate at *t1* may not be deemed appropriate at *t2*. In fact, a basic presupposition of the argument for discretion is exactly that policies accepted for one period may prove to be inappropriate for another, and therefore, policy-makers must possess the ability to shift policy as circumstances change. Such shifts in public policy (coupled with the impact that these shifts have on the expectations of economic actors), however, may prove destabilizing to the overall economic environment". (Boettke, pp. 92-93.)

264 Cordato, Welfare.., at 5.

265 Cordato, Id.

266 Boettke, Why Perestroika Failed...

For public policy purposes it is futile to judge reality by unattainable "Nirvana" standards, as Demsetz observes.[267] It is, in fact, a self-defeating argument, as Calabresi points out. To claim that it is possible to achieve an "optimal" state only if we had access to information that we cannot possibly have amounts to wishful thinking. In his words: "...the set of Pareto superior changes which would make no one worse off and at least one person better off must ex ante be a void set. For if strict or fanatical Pareto is the criterion, why wouldn't any change that belonged in the set have already been made? Since, by definition, no one would in any way be hurt by the change, why would anyone object?" For this reason he concludes: "...the Pareto criterion is of no general use as a normative guide".[268] Calabresi contends that it is arbitrary (and futile) to assume that reality is located at some point inside the production frontier, as an "imperfect" state of affairs in relation to that which could be if we possessed unattainable information.

In conclusion, ascertaining and achieving a social welfare optimum requires such a high level of information, that it becomes "non-optimal". As Kirzner argued, a situation that appears ideal may be far from ideal if it can only be attained at a high cost.[269] For

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267 In his own words: "The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing 'imperfect' institutional arrangement. This Nirvana approach differs considerably from a comparative institution approach in which the relevant choice is between alternative real institutional arrangements". (H. Demsetz, "Information and Efficiency: Another viewpoint", 12 Journal of Law and Economics, [1969], p. 1) Also, see Sowell, pp. 203-205. Twenty years before Demsetz, Hayek had clearly identified the misleading use of neo-classical models of perfect, imperfect and monopolistic competition to draw normative implications. In his words: "The economic problem is a problem of making the best use of what resources we have, and not one of what we should do if the situation were different from what actually is. There is no sense in talking of a use of resources 'as if' a perfect market existed, if this means that the resources would have to be different from what they are, or in discussing what somebody with perfect knowledge would do if our task must be to make the best use of the knowledge the existing people have. (...) [Therefore] the argument in favor of competition does not rest on the conditions that would exist if it were perfect". (Hayek, "The Meaning of Competition", p. 104.) Almost thirty years later, he restated this point: "The test [for adequate policy-making] should not be the degree of approach towards an unachievable result, but should be whether the results of a given policy exceed or fall short of the results of other available procedures". (F. A. Hayek, Law, Legislation and Liberty: The Political Order of a Free People, p. 67.)

268 G. Calabresi, "The Pointlessness of Pareto: Carrying Coase Further", 100 The Yale Law Journal, p. 1216.

269 I. Kirzner, Competition..., pp. 231-234. Ten years earlier, Kirzner had already pointed out: "(...) it is the market process that is being judged rather then the state of equilibrium the process leads toward (...) After all, in a changing world, a state of market equilibrium, as we have seen, is hardly an attainable goal. The precise degree in which the state of market equilibrium deviates

this reason, attempts to find such optimal interpersonal states are irrelevant because there is no point in comparing reality to some unattainable state, or trying to reach a state which can only be attained at such a high cost that the social welfare goal becomes non-optimum.

2.2.- The impossibility of defining predictable enforcement goals under conventional regulatory appraisal.

In addition to the lack of information held by enforcement authorities, choosing amongst welfare standards creates a lack of indeterminacy in the rule of law to be followed in policy enforcement.

The conventional regulatory appraisal of antitrust policy entails a utilitarian analysis aimed at enhancing social welfare by distinguishing between non-monopolistic and monopolistic restrictions on competition. This analysis aims to identify the effects of certain market arrangements on competition. It is here that the essential problem begins, because this is a determination that cannot be directly appraised. By definition, almost all arrangements that firms undertake restrict short-term competition, because they compromise the independence of action that firms would otherwise enjoy.

Antitrust analysis purports to determine whether these arrangements create any "social efficiencies" that could justify them, irrespective of the restrictions they introduce. It is necessary, therefore to make a positive determination of the "social efficiency" of prosecuted arrangements before they can be accepted; otherwise they will be regarded as "monopolistic" or "unfair". At first sight, this exercise seems easy, for anyone could put forward his or her own impression of whether a particular arrangement is "efficient". However, the real problem lies in reaching a unanimous conclusion about what "*social*"

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from the conditions of optimality is therefore (...) a distinctly academic question". (I. Kirzner, Market Theory and the Price System, (Princeton: Van Nostrand Co., Inc, 1963), p. 299.) See also R. Langlois, Economics as a Process: Essays in the New Institutional Economics, (Cambridge: Cambridge University Press, 1986), p. 41. Cordato argues: "the particular end-state pattern of resource allocation (is) hypothetical and irrelevant for real world appraisals of social efficiency". (Cordato, Welfare..., p. 45.)

efficiency is, in order to provide uniform principles on which to base a rule of law. Unfortunately, it this is not as simple as it appears on the surface. As Bork emphatically states: "efficiency cannot be studied directly and quantified".270

"Rule-of-reason" analysis basically construes market arrangements in the light of those efficiency criteria chosen as "socially optimal". Antitrust agencies weigh the advantages of allowing market co-operation among rivals, against the disadvantages of restraining competition. The fundamental question, however, is whether such analysis can be stable and predictable, so as to favour the emergence of a predictable "rule of law".

The answer to this question is negative because, once again, due to the subjective preferences of individuals within the market, it is not possible to make an objective rule-of-reason analysis. Choosing a "social" efficiency criterion as the mainstay for such analysis inevitably entails a utilitarian analysis, whereby interpersonal comparisons of utility are arbitrarily made. Clearly, in this appraisal only the decision-maker can actually decide what is "efficient" or "inefficient". In other words, the decision-maker possesses unaccountable discretion in classifying a given arrangement as favouring "market failures". Obviously, no rule of law can emerge from this.

To see this question more clearly, it is necessary to find the inner essence of the calculation performed by social welfare analysis. In the field of welfare economics, it is widely accepted that measuring the efficiency of a policy entails some form of cost-benefit calculation which requires interpersonal utility comparisons in order to develop aggregate welfare standards.271 On paper, efficiency analysis (or for that matter, any

270 Bork, p 192. However, this author states that: "In antitrust the required common denominator (of utility) is provided by the goal or value of consumer welfare. (Because) in a system which permits consumers to define their own welfare by their purchases, it follows, that, (...) a firm's efficiency is shown by its success." (Bork, p. 105) Although we sympathise with Bork's view under the logic imposed by the conventional paradigm, his normative analysis does not possess superior value compared with that shared among those who consider that antitrust should pursue other goals. In fact, measuring efficiency of market arrangements *from the point of view of the firm* (as Bork contends) does not necessarily fit into the logic of the conventional paradigm, to which considerations of static equilibrium and allocation of resources are central, whereas the standing of the firm in attaining its objectives in the most efficient way is clearly secondary.

271 Veljanovski, The New Law-and-Economics, p. 20.

other aggregate welfare standard) provides a useful measure against which to compare the use of a policy or a rule.

However, this calculation is misleading if we do not acknolwedge its limitations when applied as a measure of market functioning, which is comprised of the interaction of many individuals. As Knight argued: "There is a common misconception that it is possible to discuss efficiency in purely physical terms. The first principles of physics or engineering science teach that this is not true, that the term efficiency involves the idea of value, and some measure of value as well. (...) The correct definition of efficiency is the ratio, not between "output" and "input" but between *useful* output and total output or input. Hence efficiency (...) is meaningless without a measure of usefulness or value. In any attempt to understand economic efficiency, the notion of value is more obviously crucial since most economic problems are concerned with a number of kinds both of outlay and of return, and there is no conceivable way of making comparisons without first reducing all the factors to terms of a common measure".272 It is first necessary to determine *whose* efficiency before arguing *what* efficiency.

It is untrue that economic actors value the utility of their goods simultaneously, ignoring the fact that every action is creative and performed in sequence. Their marginal utilities may not only differ at each stage, but may also be incomparable. In this regard, Hans Mayer observes that whenever "all wants differing in kind or quality are not reciprocally present to one another, then the postulate of the law of equal marginal utility becomes impossible in the real world of the psyque". A forced synchronisation of utility estimates that "it is as if one were to express the experience of aesthetic value of hearing a melody –an experience determined by successive experiences of individual notes– in terms of the aesthetic value of the simultaneous harmonization of all notes of making up the melody".273 Gunning also shows that it is impossible to derive welfare judgements

272 F. Knight, Economic Organization, (Chicago: The University of Chicago Press, 1933), p. 8.

273 H. Mayer, "The Cognitive Value of Functional Theories of Price: Critic and Positive Investigations concerning the Price Problem", in Classics in Austrian Economics: A Sampling in the History of a Tradition, I. Kirzner (ed.) (London: William Pickering, 1994), pp. 81-83

based on individual preferences from a model which assumes technical and distributive efficiency.

Consider the Pareto efficiency standard, later evolved into the Kaldor-Hicks criterion. This test is an *ordinal* concept of efficiency; it does not reveal any intensity of preference or interpersonal comparability of utilities. In other words, it does not tell *the comparability* of different inputs or outputs.274 It therefore has little value when measuring individual preferences with in the context of society. In this sense, White argues that such a view would misleadingly take utility to represent interpersonally comparable magnitudes, while the choice-theoretic concept of diminishing marginal utility implies no such thing. It would require only that the individual ranks the uses(on a personal scale) to which successive units of a good might be put. Marginal utility is the agent's preference-ranking of the marginal unit, not the magnitude of pleasure afforded by that unit.275 Singham also holds similar concerns, which he relates to the case of

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274 Ironically, not even Pareto himself would have agreed to use his test for normative purposes to make interpersonal comparisons of value. Pareto was a convinced ordinalist, who believed that individuals perceive value differently, as their hierarchy of personal preferences obviously differs; and who regarded the utilitarian concept of introspective utility as unscientific. See, V. Pareto, Manual of Political Economy, Macmillan, (London, [1910] 1971), p. 113. Determining an ideal state of affairs following social welfare measures represents an impossible task. Furthermore, while it provides a ranking of allocations of economic goods between individuals, the Pareto test does not permit a ranking of all such allocations. There are many different allocations that are Pareto-optimal and which differ with respect to the distribution of real income (i.e. utility) among the individuals in society. Therefore, it becomes impossible for the would-be interventionist (antitrust) agency to determine the most adequate allocation considering the distribution of income. (Lockwood, p. 811.) For an extended critique of the use of efficiency as normative yardstick, see M. Rizzo, "The Mirage of Efficiency", 8 Hoftra Law Review [1980], pp. 641-658; and M. Rizzo, "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", 9 Journal of Legal Studies, [1980], pp. 291-318. In these articles, Rizzo clearly shows the theoretical contradictions of those who attempt to use economic efficiency as a normative yardstick against which to measure the operation of the law.

275 L. White, "Is There an Economics of Interpersonal Comparisons?", Advances of Austrian Economics, vol. 2, part A, [1995]: 138-140, 144, 146. Lionel Robbins was the first scholar to criticise such a comparison on normative grounds: "The theory of exchange does not assume that, at any point, it is necessary to compare the satisfaction which I get from the spending 6d. on bread with the satisfaction which the baker gets by receiving it. That comparison is a comparison of an entirely different nature ... It involves an element of conventional valuation Hence it is essentially normative". See L. Robbins, An Essay on the Nature and Significance of Economic Science, (New York: New York University Press, 1935), pp. 138-139. In a contrary opinion, Sen observes that "for reasons not altogether clear, interpersonal utility comparisons were then regarded as being themselves 'normative' or 'ethical' The popularity of that view is perhaps traceable to the powerful endorsement of that position by Lionel Robbins". (Sen, p. 30)

developing countries. In his view, there are shortcomings in assuming net welfare can be measured in constant dollars: "Clearly, there are major social implications of this, and one can easily envisage a series of facts where the loss of one dollar by a consumer is considered of greater effect than the gain of one dollar by a monopolist."276 Veljanovski contends that the evolved Kaldor-Hicks criterion allows for such interpersonal comparisons of utility.277 However, this is a mere delusion, since it confuses the position of individuals whose utilities are compared, with those of whoever undertake the analysis.

Indeed, it is not only that social welfare, as generally understood under the economic efficiency standard of Pareto optimality (or Kaldor-Hicks), expresses a measure of value that does not necessarily correspond with the sense of social welfare shared in society.278 It is, more importantly, that *any social welfare standard*, as understood by conventional regulatory appraisal, has to be interpreted in such a way that disregards the individuality of those to whom the standard ultimately applies. As Rawls contends, the utilitarian social cost-benefit calculation depends upon the decisions of an impartial spectator who is conceived to carry out the organisation of the desires of all persons into one coherent system of desire; it is a construction that fuses many persons into one.279 For this reason Kirzner concludes: "The notorious (and inevitable) failure of modern welfare economics to overcome the problems raised in interpersonal comparisons of utility has, quite simply, invalidated all attempts to evaluate the market in terms of resource-allocation norms".280 One could qualify this statement by stating that even though the conventional normative analysis, which differentiates between "facts" and

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276 Singham, at 370.

277 Veljanovski, The New Law-and-Economics, p. 20.

278 As Singham observes: "It is justified to say that allocative efficiency concepts must include everything to which people assign a value. This could include those items that traditionally have been perceived to be non-economic goals, such as increasing opportunities for small businesses or a public policy objective of the diffusion of power generally." (Singham at 371.)

279 For this reason, Rawls concludes that utilitarian analysis "does not take seriously the distinction between persons." See, Rawls, p. 27.

280 Kirzner, Competition ..., p. 215.

"values", is widely accepted in economic science, it is bound to clash with legal culture.[281]

Even though it appears irreconcilable with the requirements of a legal system based on the respect of individual rights, the fact that the aggregate utility has no use in measuring the well being of individuals would in itself pose no problems in measuring social performance if we assume that each individual's preference somehow accounts for society. However, aggregate welfare standards possess further problems which make them incompatible with the predictability required by the rule of law. Thus, these social welfare criteria lack the objectivity required for consistent application, a condition that is implicit in the notion of the rule of law.

For this reason, determining an ideal state of affairs based on social welfare measures represents an impossible task. While it provides (on paper) a ranking of the allocations of economic goods between individuals, no standard of social efficiency conceived in interpersonal terms, whether Pareto, Kaldor-Hicks or any other permits a predictable ranking of these allocations. In other words, there are many different allocations which differ from the distribution of real income (i.e. utility) amongst individuals in society. It therefore becomes impossible for the would-be interventionist (antitrust) agency to determine the most *adequate* allocation based on a given distribution of income.[282] Even under economic efficiency standards, the selection would require an additional criterion which is not offered by the standard itself, but by considerations of equity. It thus becomes obvious from a practical standpoint that it is impossible to derive welfare judgements in a complex market economy based on individual preferences. Some arbitrary criterion has to be introduced. The implications of this analysis are that it is impossible to preserve the integrity of individual rights, as they will no longer dictate social preferences.[283] Yet, as Calabresi observes, "many persist in using the Pareto criterion as a crutch, as if its fundamental emptiness did not matter".[284]

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281 See Katz, "Positivism ..."

282 B. Lockwood, The New Palgrave in Economics: A Dictionary of Economics, Vol. 3, J. Eatwell, M. Milgate and P. Newman (eds.), (London: Macmillan Press Ltd., 1987), p. 811.

283 P. Gunning, INTERNET www. uchulc.edu.tw/~gunning/pat/subjecti/workpape/answelf.htmm.

In conclusion, the interpersonal essence of economic efficiency makes objective appraisal impossible. Economic theory alone cannot provide an objective view of what is in fact a value concept, dependent on the normative preferences (i.e. cost-benefit) of the observer.[285] The authority has no guidance for selecting a single solution; instead, he must necessarily add his own preferences into the calculation. Obviously, this will prevent the emergence of a rule of law, because policy decisions will ultimately follow the criteria laid down by whoever is in charge of the enforcement authority.

For these reasons, the attempts by antitrust authorities to use standards of efficiency for making interpersonal comparisons of welfare amongst individuals are improper. The standards were not intended to lead to such utilitarian calculations in the first place. The limitations of making interpersonal comparisons of utility are clearly visible in the difficulties discovered in the cost-benefit legal analysis that antitrust policy-makes to develop stable legal rules.

2.3.- Consequences of the impossibility for antitrust policy to implement predictable welfare goals vis-à-vis the rule of law.

Epstein shows how difficult it is to construct a normative system that bases its criteria for judgment exclusively on an aggregate measure of social satisfaction, whether stated in the form of utility, welfare or wealth. He specifically points to the difficulty of reconciling antitrust postulates with the notions of property rights and corrective justice.[286]

p. 7.

284 Calabresi, 1229.

285 Sen argues that the calculation based on interpersonal comparisons of utility is not normative or ethical. Instead, he claims, it was part of Lionel Robbins's reasoning that established the negative proposition that interpersonal comparisons cannot be made 'scientifically'. (Sen, p. 30 footnote). Even accepting Sen's contention, the conclusion is altogether the same: the rule-of-reason calculation cannot be made in an objective way, and it therefore obliges the enforcement agency to make an arbitrary decision.

286 See in general, Epstein, Private Property...

The ultimate reason for this inconsistency stems from the impossibility of reconciling the utilitarian essence of conventional regulatory appraisal, (and in particular, of antitrust policy) with the standards of predictability required under a system based on the rule of law. The *raison d' être* of such regulation --to achieve a preconceived form of "well-being", "social happiness" or the like-- is merely an incidental by-product of consequentialism. Its success is judged by its capacity to achieve the chosen form of "social good".287 Under this perspective the integrity of property rights and justice yields to superior goals defined by the law-giver under a social welfare formula, which in the case of antitrust policy are most often (albeit not exclusively) embodied in the superior Pareto formula of "economic efficiency".

There is a fundamental incompatibility between the rule of law and conventional regulatory appraisal, arising from the impossibility of developing stable and predictable legal rules from policy enforcement. Regardless as to whether it follows a prior ruling, each policy decision is adopted on the basis of its presumed results. Because of this, the authority has to determine whether the results of a given policy initiative meet the chosen standard. However, the information held by the authority when making choices between alternative paths of enforcement is insufficient to allow him a picture of the economic causalities involved. Again, the subjective nature of such information will prevent the authority from gaining full knowledge of the underlying causalities which integrate the functioning of the markets he wants to regulate. In short, the authority will be unable to forecast what the results from intervention will be.288

Judging the success of a policy on the basis of its capacity to achieve its goals creates problems because, as Rizzo reminds us, "a utilitarian or balancing framework

287 Rizzo argues that the more goal-oriented legislation is, the more likely it is to be based on cost-benefit considerations; whereas the more abstract a legal order is, the more heavily it depends on general rules. (Rizzo, "Rules", pp. 866-867, 873-874.)

288 See in general, S. Ikeda, Dynamics of the Mixed Economy: Toward a theory of interventionism, (New York: Routledge, 1997).

would require us to trace the full effects of each (tentative) judicial decision, and then evaluate it against the particular utilitarian standard adopted", which places an unbearable burden of information on the shoulders of whoever must decide the success of a policy.[289]

Of course, the belief that cost-benefit utilitarian calculations are possible is an indirect result of the pretence of perfect knowledge that conventional regulatory appraisal vests upon the observer of the social system. The observer is assumed to have been given the necessary information from individuals and their transactions to know how far or near they are from the "optimum" (i.e. equilibrium) and therefore, what steps are necessary to achieve such an "efficient" social state. Social cost-benefit welfare calculations are possible as soon as it is realised that individuals are considered to hold equal preferences and tastes.

Obviously, this logic clashes with the subjective nature of market expectations. How can the successful intervention by antitrust authorities make prices equal to marginal costs (i.e. the ultimate goal of antitrust policy), while we have to acknowledge that the costs which individuals face in their transactions are entirely dependent on the value of the parties taking part in the transaction rather than third parties.

The inherent limitation of the welfare endeavours of antitrust agencies therefore, is that they assume an impossible condition for framing public policy; namely, that the information necessary for the authority to intervene efficiently will somehow be readily available. This is precisely the problem that has to be solved; it is thus not possible to assume that a central agency has the information necessary to co-ordinate from above the activities of everyone in society from above. In complex social orders, such information is not given to anyone in its entirety.

289 M. Rizzo, "Rules versus Cost-Benefit Analysis in the Common Law", 4 The Cato Journal [1985], p. 873.

No uniform legal standard embodying "acceptable" conducts can develop out of social cost-benefit calculations, because by their very nature, the objectives in such utilitarian calculation are to consider the effect of the measure in the particular context where parties interact. In other words, each case will follow an "ad-hoc" standard of welfare created by the enforcement authority. Hence the trade-off is inevitably linked to particular conditions and features of the prosecuted case, which can hardly be reproduced in future cases, as demanded by the rule of precedent.

There is no way in which a rule can develop which constrains decisional activity to objective parameters: it will always depend on the particular "measure" used by the decision maker to weigh the utilities of individuals. The diminished position of those individuals whose utility is decided by another is irrelevant in this matter. Any utilitarian assessment rendered in a particular case will inevitably constitute the normative imposition of whoever enforces the criterion. Whether "social welfare" has been achieved will depend on the personal opinion of whoever interprets the rule.

For example, under a rule-of-reason analysis, a corporate form may be either condemned or authorised depending on the facts surrounding its functioning in the market. From this point of view, no two cases are similar and one can hardly expect the presence of any pattern that could lead to the development of legal standards.

3.- <u>THE INADEQUACY OF CONVENTIONAL LEGAL MECHANISMS FOR PREVENTING THE EROSION OF THE RULE OF LAW UNDER ANTITRUST PROCEEDINGS.</u>

The combined effects of the misleading conventional appraisal of market interaction and the impossibility of defining social welfare objectively provide antitrust authorities with unlimited scope for discretion in the cases brought before them. Obviously, under such circumstances, it is impossible to define a stable and predictable administrative decision-making process, and this leads to the erosion of the rule of law. Antitrust scholars and policy-makers are aware of the erosive effects on the rule of law caused by unaccountable discretion which results from deciding social welfare matters from a conventional paradigm of regulation. For this reason, they have attempted various initiatives aimed at circumscribing the range of options that antitrust authorities can choose from in their decision-making.

In this section we explore how formal legal positivism is unsuitable for providing the tools of legal interpretation that could otherwise control the discretion of the regulatory authorities, and thwart the erosive effect of principles sustained by the conventional paradigm on the rule of law.

The lack of referential normative values against which instrumental regulation could be contrasted made scholars prone to rely on the wording of these rules in order to control any possible unwarranted discretion on the side of the enforcement authority. Great care was therefore exercised in drafting these rules, so that the conduct of the enforcement authority was subjected to "predictable boundaries". Legal positivism induced scholars to believe that the certainty of legal rules meant they could be appropriately worded in order to incorporate social orders dictated by the ruler. Legal subjects only had to check the text of the codes, statutes, decrees and other "official" statements to ascertain the extent of their obligations.

In this sense, the instrumental view of legal rules is responsible for obscuring the sense of certainty in the law, by confusing it with *detail*. Epstein claims that such a view is a misleading appraisal of the nature and function of a legal system. In his words: "[Under the instrumental appraisal] the legal system must specify in great detail the precise courses of action that individuals are then bound to follow. In effect, the system makes most of the major decisions about the allocation of resources through its central, public agencies and allows individuals the right to make adjustments in their own cases only at the margins. Such is, for example, the way a system of rigid wage and price controls must in principle work. The system sets the terms on which exchange can take place: individuals can at most opt out of the system. Rules with such specificity are of course difficult to formulate and enforce. Yet even if these difficulties are surmounted, it remains clear that within this regime the rules as promulgated have a very short useful life, because the legal systems must take quickly into account exogenous changes in supply and demand in setting out their schedules for production and exchange".[290]

It would be impossible for the legitimate authority to gather all the information required for drafting legal rules in such a way as to adapt them to unforeseen circumstances, which would be a condition for achieving social efficiency in a world of changing individual preferences.

Similarly, detailed legal rules would not necessarily enable individuals to obtain a precise sense of their social duties. Howard noted the failed endeavours of regulators to develop detailed rules which could make the law "clear": "To most experts, the highest art of American lawmaking is precision. Only with precision can law achieve a scientific certainty. By the crafting of words, lawmakers will anticipate every situation, every exception. With obligations set forth precisely, everyone will know where they stand. Truth emerges in the crucible of the democratic process, and legal experts use their logic to transform it into a detailed guide for action. The greater the specificity, the more certain we are that we are providing a government of laws, not men. (...) Making law detailed, the theory goes permits it to act as a clear guide. People will know exactly what is required". He continues: "But modern law is unknowable. It is too detailed. (...) The drive for certainty has destroyed, not enhanced, law's ability to act as a guide. All you have to do is pick up any volume of the Code of Federal Regulations to confirm the truth (...) that regulation has become so elaborate and technical that it is beyond the understanding of all but a handful of Mandarins".[291]

The *kind* of certainty required in market transactions is not related to the fact that legal rules occurs in written form through codes and statutes. Market certainty depends on the extent to which individuals perceive their arrangements to be binding, in the sense that they effectively uphold their legitimate expectations vis-à-vis other individuals in the

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290 R. Epstein, "The Static Conception of the Common Law," 9 Journal of Legal Studies [1980], p. 254.

291 P. Howard, The Death of Common Sense, (New York: Warner Books, 1994), p. 30.

market.292 These are expectations built upon social consent; therefore, they entail abstract principles which are sometimes impossible to express in a written formula. In other words, they are expectations which comprise will of the many, and which may or may not coincide with that of the formal authority.

Consequently, stability in time and the adaptation of the rule of law to unforeseen circumstances both arise from the involvement of more individuals in the law-making process. This is a question that Leoni observes: "The certainty of the law, in the sense of a written formula, refers to a state of affairs inevitably conditioned by the possibility that the present law may be replaced at any moment by a subsequent law. The more intense and accelerated the process of law-making, the more uncertain the duration of present legislation. Moreover, there is nothing to prevent a law, certain in the above-mentioned

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292 The particular meaning attached to the *certainty of the law* explains, to a great extent, the diverging perception of public law in Civil Law systems in Continental Europe, compared with Common Law countries (particularly, the United States and Great Britain) with regard to the powers of government intervention. Cohen Tanugi contrasts the emergence of regulatory agencies in Common Law countries, which are the outcome of negotiations to give a special status to *specific interests* in society, such as consumers (the case of antitrust), ethnic minorities, environmentalists, and so on; with the development that occurred in France (and other Civil Law countries) where intervention has been made through the ambiguous and generalised concepts of *intérêt général* or the *service public*. He writes: "Aux Etats-Unis ... les divers intérêts affectés par telle ou telle politique d'une agence administratif ont acquis le droit de participer à la formulation de cette politique par des procédures contradictoires formalisées, et de s'assurer un contrôle judiciaire sur l'équlibre réalisé entre les intérêts concurrents par l'Administration". By constrast, in France: "Le concept central et fondateur du droit administratif francais, comme de la rhétorique politique, est celui de l' intérêt général. Cést lui que sous-tend et légitime les notions de puissance publique et de service public, critères ayant historiquement servi à déterminer, à leur tour, la compétence du juge administratif et l'applicabilité du droit administratif. C'est parce que la puissance publique et le service public représentent et défendent l'intérêt déneral qu'ils soivent bénéficier du statut exorbitant que leur confère le régime administratif. On retrouve ici, à un autre niveau et au profit de l'executif cette fois, la théorie que fonde la souveraineté de la loi, comme expression de la volonté générale". (L. Cohen-Tanugi, Le droit sans l'Etat: Sur la démocratie en France et en Amérique (Paris: PUF, 1985), pp. 110-111). The fact that *written certainty* pervades Civil Law systems, such as those of Latin America, whereas *certainty as expectancy* dominates in Common Law countries may well explain, from a legal perspective, why judicial activity in the former appears to be based on the abstract principles of a legislated constitution, whereas in England judicial decisions are at *the very foundation* of the English constitution. This entails two differing levels of certainty: whereas all the guarantees that Continental constitutions afford to citizens relate to the suspension or withdrawal of their rights by some power that is above the ordinary law of the land, in England such a possibility is excluded on principle. See F. A. Hayek, The Constitution of Liberty (London: Routledge & Kegan Paul Ltd., 1960), Chapter XVIII.

sense, from being unpredictably changed by another law no less 'certain' than the previous one".293

These considerations allow us to understand why mechanisms conventionally devised for preserving the rule of law in antitrust policy have not succeeded in fulfilling their purposes. These tools endeavour to restrict the conduct of antitrust authorities by placing careful limits on their procedural activities, yet they are unable to control the interpretations given to economic causalities which, as we have seen, are founded on the false premise of objectivism.

For example, in the United States, the Federal Trade Commission and the Department of Justice frequently issue "general guidelines" on specific aspects of the policy.294 Allegedly, these guidelines provide business with "guidance" concerning antitrust enforcement and procedures,295 and give some guidance on how authorities *could* decide in the presence of "certain commonly occurring issues affecting [their] own enforcement decisions".296 Similarly, the EU Commission DG IV has issued several "Comfort Letters" and "Short-form Exemptions" for particular individuals.297 A similar practice has sprung up in several Latin American antitrust agencies, most notably Mexico and Venezuela, which issue "opinions" on the legal position of particular firms in relation to antitrust provisions.298 Other initiatives are more formal and involve law-making

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293 Leoni, p. 80.

294 An example of this is the "Antitrust Enforcement Guidelines for International Operations" of April, 1995 and the "Horizontal Merger Guidelines" of April 1992 and revised in April 1997, issued by the Antitrust Division of the U.S. Department of Justice and the U.S. Federal Trade Commission.

295 Antitrust Enforcement Guidelines for International Operations, Antitrust Division, U.S. Department of Justice, Washington, DC, 1997, 1.

296 Id.

297 Korah, p. 277.

298 C. Curiel, Elementos para la aplicación de políticas de competencia en economías en transición. La Experiencia en Venezuela. Paper presented at the meeting "Políticas de Competencia en America Latina y el Caribe", Superintendencia Pro-Competencia-UNCTAD, Caracas, 23-24 October 1995.

processes. An example can be found in the European Commission regulations on Group Exemptions, which many Latin American countries are introducing in their own legal schemes. Due to the structure of antitrust legislation into Civil Law jurisdictions, most agreements entered into by entrepreneurs are subject to a formal prohibition, which requires express lifting before the arrangement can be executed. Group Exemptions prevent unnecessary delays in the process of evaluation, since they allow firms a mechanism for determining with some certainty whether their undertakings would qualify under the rule. Presumably, that should give them legal certainty regarding their status under antitrust legislation.

However, these initiatives have limited effects because they either restrict their effects to the particular circumstances of the requests before them, or they become too vague if applied to larger groups of individuals, or they simply do not entail a real binding commitment for the deciding authority, which remains free to change the "precedent" created.

For example, Comfort Letters or "legal opinions" are not legally binding on the enforcement agency, and therefore provide little shelter for the parties if a prosecution is initiated. As Korah argues, "Comfort letters stating that competition is not restricted owing to the parties' small market may be of little use a few years later when their business has been successful".299 In some countries, clear limitations are imposed on the authority of administrative bodies to give advance rulings or opinions on prospective cases. Although the purpose of this limitation is to avoid leaving out any potential party to the procedure without the possibility of defending their rights, this constraint represents a serious limitation on the assurances that antitrust agencies can give to businesses that they will not be prosecuted.

Furthermore, systems such as the European Group Exemptions, which has been adopted in some Latin American jurisdictions, contain serious flaws, which in fact get reproduced. The Group Exemptions are intended to function as guidelines for

299 See Korah, p. 277.

arrangements entered into by firms, classifying them into "black", "white" and "grey" lists to indicate their degree of "restriction". Generally, distinctions categorising each list are based on the temporal span of the arrangement convened: the longer the restriction imposed, the more difficult it is to qualify as "white".

However, in practice it is very difficult to reconcile the workings of the "Group Exemptions regime" with the certainty required by businesses in their economic transactions. How can a business find out which "list" their particular undertaking is on? How long should a restriction last to qualify as exempt? What share of the market should remain within the threshold of legality? How many outlets should the restriction make inadmissible? What efficiencies should the agreement provide? How can these be proved? As Korah firmly contends, "these formalistic categories have nothing to do with competition policy."300. These are only few of the questions arising from the omissions of the Group Exemptions.

Finally, issuing guidelines provides no significant assurance about the commitment of the authority in deciding cases in a manner consistent with prior decisions. Consider the carefully balanced words used by the U.S. Antitrust Enforcement Guidelines for International Operations: "Several caveats (...) apply to use of the guidelines. First, these Guidelines are not intended to be a restatement of the law as it has developed in the courts."301 Later, in a footnote, it is made even clearer that, "The (U.S. Department of Justice) may undertake a more extensive market power analysis under the rule of reason for enforcement purposes than some courts would require in litigation."302 In plain terms, these guidelines do not ensure that decisions taken will follow any settled criteria.

300 Korah, p. 278. In addition, these initiatives generally clash with the ordinary intervention of Civil Law systems through the principles of Administrative Law. Under these principles, authorising a particular business conduct is regarded as an act with special effects, in the legal sphere, for the beneficiary of the authorisation. In other words, they are, by definition, individual authorisations; the legal systems do not contemplate such things as "Global" exemptions, which go against the need for certainty demanded by the *Staatrecht*.

301 Antitrust Enforcement Guildelines ..., p. 1.

302 Id.

The basic reason for the lack of effective control over administrative discretion is found in the formal legal culture pervading the drafting and interpretation of these legal rules. The interpretation placed on them makes any endeavour to define legal rules difficult due to their formalistic, rigid and contrived appraisal of markets, which are above all an evolving social phenomena. Korah has noticed this in the work of the European Commission: "Instead of drawing its regulations in broad economic terms, (...) the Commission has drafted them in legalistic detail."[303] There is no question that the ultimate cause for such excessive formalism and the lack of effective judicial review can be found in the legal culture of conventional regulation, whose intellectual roots are grounded in the ideology of positivism. The problem with these initiatives is that they place their effectiveness in the written nature of their instruments, a condition that does not by any means ensure their flexible interpretation by the authorities as circumstances change.

These problems could be avoided if the authority were subject to some sort of political accountability which compensated for the lack of judicial control. The rule of law would still be preserved if market participants knew in advance what policy goals are, or more precisely, who the beneficiaries of the policy would be under each particular set of circumstances. However, this is impossible in antitrust proceedings, because the nature of decisions made in these instances relate to changing "policy" goals, whose definition depends on the personal normative preferences of the decision-maker in the last resort. As we have seen, these preferences are already built into the mind of the decision-maker as a consequence of the misleading closed-end picture that neo-classical economic theory conveys of markets. Only by challenging this contrived picture will it be possible to question positive theory, normative appraisal and the implications of antitrust enforcement for business conduct.

In the end, all the conditions will be in place to erode the basic formulation of the rule of law because the antitrust authority will have incentives to impose its own standard

303 Korah, p. 277.

of social welfare interpretation, thus framing legal rules according to its will, not the will of the Law.

By contrast, in a system where the rule of law effectively prevails, legal procedures would focus on "finding upon the facts in dispute and an application of the law of the land to the facts so found, including where required a ruling upon any disputed question of law". Rulings are imposed following the rationale of the Law, not men: *non sub homine sed sub lege*. In its absence, cases turn into "a quasi-judicial situation where such process is replaced by 'administrative action', which might involve 'considerations of public policy' or 'discretion'".[304]

In practice, such discretion may easily degenerate into arbitrary decisions, as Pound noted insightfully: "[there is a] tendency is to set up and give effect to policies beyond the statutes governing the action of the administrative agency [because] it is very easy to say that the public interest demands or justifies activity beyond or in contravention of the statute and to cover this up by a general pronouncement upon the case".[305] Indeed, under these proceedings, there is always the temptation "to identify in advance one side of a controversy with the public interest and to find the facts accordingly. This tendency is the more likely when the administrative agency combines undifferentiated investigating, prosecuting and adjudicative functions. Under such a combination of functions it is not easy to realize that the policy is to be applied in determining the legal effect of the facts under the statute, not to determining the facts".[306]

In this case, there is no way a firm or firms investigated could escape with their property rights intact, as it would not be possible for them to demonstrate their "innocence" on the basis of a social efficiency analysis, because of the way the analysis

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304 Report of the Committee on Ministers' Powers, Cmd. 4060 (1932), pp. 73, 74, 81) (quoted by Stevens and Yamey, pp. 24-25, footnote 6.)

305 R. Pound, "Administrative Procedure Legislation (For the Minority Report)", 26 American Bar Association Journal, [1941], p. 667.

306 Id.

operates.[307] This means that antitrust agencies are, in the words of Stevens and Yamey, "required to act without certainty and on the balance of probabilities".[308]

4.- THE LIKELY EFFECTS OF THE LACK OF ACCOUNTABILITY OF LATIN AMERICA'S POLITICAL INSTITUTIONS.

In this section we will explore the economic effects of the erosion of the rule of law on the behaviour of market agents in the light of the Latin American experience. We will also analyse the problems faced by the political institutions in the region when creating the appropriate conditions for the promotion of innovation and entrepreneurship. Our analysis centres on the informational disadvantages of enforcing antitrust policy in weak institutional settings, such as Latin American countries.

There are clear informational disadvantages in enforcing antitrust policy, as unaccountable government intervention enhances the uncertainty of individuals about their entitlements, and about their capacity to trade within the market.

Political institutions in Latin America suffer from a chronic lack of accountability. This creates the right conditions for the creation of legal monopolies and privileges to protect the "legalised" rent-seeking behaviour of those groups or individuals who possess stronger lobbying capacity.[309]

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307 As Pound noted in his *The Minority Report*, there are clear losses which would not occur if a rule of law prevailed, when implementing this sort of administrative "justice". These are: a) there is a failure to hear both sides; b) undesirable secrecy of proceedings through private consultations and undisclosed reports; c) a determination with no basis in substantial evidence; d) a risk that the policies implemented will be given effect outside statutory provisions; e) that policy will determine the relevant facts, and not the contrary; and finally, f) that there will be an undifferentiated finding of facts and law. (R. Pound, "Administrative Procedure Legislation (For the Minority Report)", 26 American Bar Association Journal, [1941], 664-678)

308 Stevens and Yamey, p. 91.

309 A. Krueger, "Government Failures in Development", 4 Journal of Economic Perspectives, [1990]: 9-23.

Political means of control during the process of enacting legislation which affects markets are particularly fragile. The capacity of the region's governments to carry out their functions was never high, even before the economic crisis of the 1980s. These governments are easily influenced by private interests; thus they lack the autonomy to formulate and execute policies that benefit the general population, rather than serving the narrow interests of the controlling elite. As Naím states, "Latin American governments have traditionally exhibited a dismal capacity for preventing the interests of small groups and even families or individuals from taking precedence over the public interest. [Not surprisingly] the poor performance of the Latin American state reflects a distribution of economic and political power that biases public action in favour of the rich, squeezes the middle class, and excludes the poor".[310] The pre-eminence of local and private interests, reinforced by the weakness of formal institutions, is a clear feature of the law-making process.[311]

In this context, antitrust policy entails a clear risk of undermining the already weak Latin American institutional setting even further by creating a new source of unaccountable discretion in enforcement agencies in the region. Thus, due to the unaccountable nature of antitrust policy, individual rights do not provide an effective safeguard against political actors competing for the use of social resources. The appropriation of these resources will be exploited by whoever is in a position to do so effectively. Political processes possess a dynamic of their own which may distort market functioning as they erode the expectations of individuals participating in the market, because political markets tend to function on the basis of intangible factors that are difficult to grasp.

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310 Naím, Latin America's... at 13.

311 See K. Karst and K. Rossenn, Law and Development in Latin America: A case book (Berkeley: University of California Press, 1975), p. 61. Also, C. Gunnarson, "What is New and What is Institutional in the New Institutional Economics? An Essay on Old and New Institutionalism and the Role of the State in Developing Countries", 39 Scandinavian Economic History Review, [1991] 43-67.

The presence of unaccountable players in the system may obstruct institutional transparency. According to Koppl's "Big Players" theory, the orderliness of market processes, which are dependent upon the social environment in which individuals interact, may become severely disrupted by the presence of "Big Players" in the system.[312] This could obviously be extended to unaccountable antitrust enforcement agencies. Big Players emerge whenever the atomistic structure of the system is lost due to institutional failures, and some individuals gain greater of comprehensibility power. Their activity therefore adversely affects the economic performance of a given social system because they become immune from the profit and loss consequences of their decisions. They effectively become unaccountable for the consequences of their actions, which produces erratic and confusing signals that destroy the expectations of other market participants. The discretion exercised in the use of such power disrupts the process of natural selection in the market.[313]

The economic problems raised by government discretion are essentially related to their disruptive effects on individuals' expectations of the market. The deficiencies of Latin American institutions aggravate the uncertainty of market actors and citizens, who are less able to predict the outcomes of social processes; obviously, these shortcomings also influence their perceptions of their respective spheres of appropriation of social resources (viz., customary property rights).

In Latin America, the lack of predictability of the institutional framework in the region is clearly linked to the pre-eminence of government intervention in economic and

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312 R. Koppl and L. Yeager. "Big Players and Herding in Asset Markets: The Case of the Russian Ruble" 33 Exploration in Economic History [1996]: 367-383. Also, William Butos and Roger Koppl. "Hayekian Expectations: Theory and Empirical Applications" 4 Constitutional Political Economy [1993]: 303-329.

313 Butos and Koppl, pp. 322-323. Big Players need not be government officials, although these play an important part. In general, the deterioration of the private allocation of property rights favours the emergence of unpredictable Big Players outside the realm of government. Examples abound: law firms possessing privileged ascendancy over government officials in claiming a "bigger share" of social resources on their client's behalf; economic experts with persuasive reputation over less trained officials, whose advice becomes crucial in establishing to whom resources should be allocated; less efficient competitors possessing stronger political clout in order to obtain social resources from political interaction; and so on.

social affairs. The presence of the traditional Latin American figure of *Caudillo*, which has dominated the political scene since the start of independence, is still felt. However, today this presence is revealed in various forms of interventionism which are exercised most frequently by the executive branch. This is often not subject to effective political accountability by other branches.[314]

These institutional conditions hinder the achievement of improved standards of institutional efficiency and economic growth, as their activity prevents the flow of useful information about trade in social resources through the system.

Businesses have great difficulty in ascertaining the laws governing particular transactions. As Karst and Rossenn observe, "it is not uncommon to find several decisions by the same court on different sides of an issue. Instead of amending basic code provisions, Latin American [legal] practice is generally to adopt supplemental legislation, which, in turn, is amended and amended again. Frequently, one is forced to read a host of separate statutes and decrees regulating a given subject (and many others as well) and then undertake the jigsaw job of piercing together the provisions still in force to find the governing law. Hence, it is quite common to discover that the authorities charged with administering a particular body of law are unaware of significant changes in the statutory or case law. Inertia, ignorance, and inability to keep abreast of rapid-fire legislative change frequently combine to produce substantial differences between the formal norm and the law actually being applied".[315]

In the field of competition the lack of reliable institutions is even more problematic: "court systems in Latin America suffer from long delays, cumbersome administrative

314 Concerning the lack of accountability, Borner et al. contend: "The main cause of institutional uncertainty in Latin America is that checks and balances are not present. Instead of three balancing powers, the typical Latin American country has a very powerful executive that can change laws and enforcement at will. No judiciary will monitor and no legislature, neither parliament nor voters, can efficiently protest against this discretionary power. The executive can do virtually whatever it likes, and the only reaction of the people is to try to escape by submerging themselves in the informal sector or leaving the country". (Borner et al., p. 28.)

315 Karst and Rossenn, p. 66.

procedures, judges with insufficient training particular in fields like competition policy, and unpredictable and non-transparent results in the absence of deciding like cases in a like manner".316

The legal system in Latin America is full of contradictions and paradoxes: for example, there tends to be excessive emphasis on the formalities of legal rules. However, the attitude of contrived legalism towards formal institutions which prevails in the region has little effect on the effective enforcement of rules. In this sense, Karst and Rossenn contend: "where there is some gap between the law on the books and the law in practice in all countries, the gap is notoriously large in Latin America. Despite an impressive amount of concern for the appearance of legality, a strikingly large number of legal norms are honored only in the breach".317

Legalism is frequently synonymous with excessive governmental interference in the individual sphere. As a result of this excessive intervention, there is a strong feeling that new formal institutions or practices ought not to be adopted without prior legislation. This attitude is well expressed in the maxim that in the realm of public law, individuals may only do what is authorised by the legal rules, whereas in the realm of private law, individuals may act freely unless otherwise prevented by the applicable legal rule.

In the realm of production these principles result in constant restraints on private production and entrepreneurial initiative because of the extensiveness of matters regulated by public law, and particularly of those concerning the regulation of markets. The underlying institutional framework governing the effectiveness of social and economic relationships among individuals in the region has diverged from the formal set

316 Rowat, p. 15. Based on the experience of Argentinian and Venezuelan commercial courts, Ulen and Buscaglia have attempted to develop an economic analysis of the court system in these two countries. They reached the conclusion that the performance of the system is poor because courts are internally organized, as well as the method of appointment of judges and magistrates. (See T. Ulen and E. Buscaglia, A Quantitative Assessment of the Efficiency of the Judicial Sector in Latin America, paper presented at the American Law and Economics Association Annual Meeting, University of California, Berkeley, May 13-14, 1995).

317 Karst and Rossenn, p. 58.

of rules; this phenomenon has influenced the attitude of Latin Americans towards their governments reinforcing their disregard for formal legal rules, and has encouraged an arrogant official attitude towards individual rights and wealth creation.

Latin American formal institutions are highly fragile. Only the elite, and the relatively small but growing middle class use the formal legal system.[318] Formal institutions do not penetrate into the mass of the population, due to the high costs of compliance,[319] the lack of a proper court system in the provinces, and the failures of the system to provide justice.[320] The institutional arrangement of social groupings reinforces the search for solutions to potential or actual disputes outside of institutions officially established such as courts. Thus, most disputes are decided by informal, yet effective, mechanisms of consensus which are administered by local leaders, or possibly the state.[321] Nor is there any assurance that institutions will follow formally stated goals. In short, the rules enacted by formal authorities do not correspond with rules implemented by society. As a consequence, decision-making authorities lack legitimacy, and individuals tend to make transactions outside of the legal rules.

The presence of Big Players in the economies of the region could create major problems for these economies once the initial economic stabilisation attempted by institutional reforms is achieved.[322]

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318 Karst and Rossenn, p. 65.

319 A very popular study about the costs of legality in Peru is found in Hernando De Soto, The Other Path, (New York: Harper & Row, 1989.) On the informal sector in Latin America, see A. Portes and R. Schauffler, The Informal Economy in Latin America: Definition, Measurement and Policies, Working Paper No. 5, Program in Comparative International Development, Department of Sociology, John Hopkings University, December 1992. www.jhu.edu/~soc/.ladark/.working_papers/.5

320 See, E. Buscaglia and T. Ulen, A Quantitative Assessment of the Efficiency of the Judicial Sector in Latin America, paper presented at the American Law and Economics Association Annual Meeting, University of California, Berkeley, May 13-14, 1995.

321 See, I. De León and J. R. Padilla, "La Solución de Controversias en Venezuela: Qué hacer," Venezuela Analítica, Caracas, June 1996.

322 See Borner et al., pp. 16,19-20, 27-28. Gómez also highlights the effects of the unpredictability of official policies in discouraging firms from investing. In the case of Latin America, this is evident in specific fields such as monetary policy, or more generally in the reversal of *apertura* when political costs are deemed *too high*. In his words: "For multinationals, the problems

These considerations play a major part in the consequences of enforcing antitrust policy in weak institutional settings. The absence of clear criteria on which to base the restrictive nature of a market undertaking obscures the legal consequences and potential risks that could be impose. The lack of effective judicial control and predictable standards encourages the emergence of "Big Players" and therefore undermines the subjective expectations of market participants, who could otherwise co-ordinate their plans efficiently. As Borner et al. point out: "Uncertainties about the nature and enforcement of the 'rules of the game' can have devastating effects on private investment and specialization. Such institutional uncertainties arise when the executive has highly discretionary powers to change and enforce the law arbitrarily. Any reforms designed to enhance specialization and growth must first increase institutional certainty. Executive power must be more answerable in order to stabilise the institutional rules of the game and thus allow growth-enhancing interpersonal and intertemporal exchange".323

Consequently, antitrust policy causes innovative businesses to refrain from certain activities that could be regarded as "illegitimate" exercises of market power left to the discretion of these "Big Players". By enhancing market uncertainty, antitrust inhibits economic exchanges and the competition process, which would otherwise allow firms to "unfold" new information and create new goods and services. These firms are then limited in their discovery of new opportunities and ability to exercise entrepreneurship through competition.324

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encountered [in Latin America] center on currency volatility, such as that triggered by the 1994 Mexican peso crisis, and throwbacks in economic policy, such as occurred in Venezuela. Exchange rate fluctuations can render a plant uncompetitive from one day to the next, or spell losses when earnings are translated into the multinational's home currency. Changes in tariffs can cause havoc for multinationals that are in the process of choosing between targeting a particular country as an export market or as a manufacturing base, particularly in the case of complex products with some parts locally made and some imported. For new entrants that have descended on the region with little experience, such as Wal-Mart, the Mexican peso crisis proved so costly that it halted plans for expansion; more experienced firms avoided losses by holding local cash to a minimum. One lesson from recent experience is the crucial role of financial management. For both multinational companies and Latin American firms in general, the chief financial executive is often a key decision-maker, holding a degree of power that is uncommon among firms that operate only in developed countries". (Gómez, pp. 242-243.)

323 Borner et al., p. 5.

324 The benefits of discovering new information that would otherwise remain "unfolded" is perhaps

As a result of its lack of accountability and wide discretionary powers, antitrust does not protect, but diminishes individual rights. A defective determination of its capacity to appropriate social resources stimulates their misallocation because they are not assigned on the basis of efficient decisions made by legitimate holders. On the contrary, allocation proceeds according to the erratic guidelines made on the basis of (uncontrolled) administrative decisions of antitrust authorities, which are more concerned with only allowing firms of a "desirable" size in the market rather than with their efficient functioning.

Going beyond the formal goals of antitrust legislation, it is perhaps more important to ascertain the political mechanisms that affect individual rights as they are likely to occur in the field of antitrust regulation. Such an analysis will provide insights into how antitrust policy could discourage entrepreneurship and firms' willingness to compete.

Consequently, the main problem faced by a policy aimed at promoting competition in the region is how to neutralise the behaviour of Big Players in the field of antitrust policy; and more broadly, the sources and effects of anti-competitive acts, judicial inefficiencies, lack of political accountability, and the introduction of constitutional control. These are the elements that need to be considered in the promotion of competition in the region.

In this context, competition advocacy could play an important role as a catalyst for nascent market institutions in Latin America by addressing governmental discretion and supporting individual expectations in the market.

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the most important feature of market functioning, which is inevitably frustrated by antitrust enforcement. (See I. Kirzner, Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach, 35 Journal of Economic Literature [1997], pp. 60-84.

5.- CONCLUSIONS: DO WE NEED A CHANGE IN THE CONVENTIONAL APPROACH TO REGULATION?

Market order entails a myriad of restrictive agreements on rivalry and the entry of market participants, but not all of them are "monopolistic". It is the role of sound antitrust policy to distinguish those that are efficient from those that are monopolistic. To do so, we have seen earlier that antitrust judges and policy-makers attempt to facilitate analysis by developing legal proxies aimed at distinguishing the effects of these arrangements and economic organisation on the market.[325]

But conventional legal analysis is not very helpful in providing insights into the monopolistic intentions of those who restrict trade. By definition, legal proxies can only make an *ex ante* appraisal of the assumed effects of economic organisation on markets. However, inascertaining whether the transacting parties intend to impose a monopolistic cost upon society inevitably demands *ex post* analysis of the economic environment within which the transaction produces its effects. The most that such proxies can do is to develop tentative hypotheses on the likely economic effects of certain transactions, on the basis of the premises of conventional economic theory. Consequently, such proxies cannot avoid reproducing prior legal decisions, and thereby the conventional economic theory upon which the former is based.

However, economic theory failed to provide stability to these legal proxies; hence, it could not set forth reliable grounds for the emergence of a rule of law. Original "structural" explanations about market causalities that linked the conduct of firms to market structure were later replaced by "dynamic" versions, as the empirical evidence encouraged new approaches to the conduct of firms and entrepreneurs in the market. However, none of these succeeded in conveying the fundamental evolution of market interaction, where the subjective expectations of economic agents integrate in a complex web of fluid and changing information.

325 See Chapter II.

This is obviously a fundamental question that deals with the difficulties of the conventional paradigm of regulation in offering sensible epistemological explanations of market functioning, which are capable of guiding policy decision-making processes. The question lies in whether market relations can be appraised objectively, which is currently the underlying assumption of the conventional paradigm.

This is a crucial issue, since by assuming that objective market appraisal is not possible, it is necessary to conclude that *any* model of industrial organisation under the SCP paradigm will possess clear epistemological flaws that prevent any meaningful light being shed on the way actors behave in the market. In the absence of a settled core of antitrust economic theory from which to develop stable legal doctrines and rules, it is impossible to conclude that this policy can distinguish objectively monopolistic restrictive arrangements from non-monopolistic ones.

These limitations have not been seriously addressed in the empirical reappraisal of the SCP paradigm, from "structural" to "dynamic" explanations, which has characterised the research of antitrust scholars since Bain's theories. Quite the reverse, the reappraisal has seldom criticised the intermediate "dynamic" models developed to deal with the insufficiencies of the initial SCP paradigm. For these antitrust scholars, the models provide an adequate explanation of market phenomena, from which they derive their conclusions on the need for antitrust enforcement.

Sowell observes how antitrust policy is firmly rooted in the assumption of objectivism: "Antitrust laws, like all forms of third party monitoring, depend for their social effectiveness on the articulation of characteristics objectively observable (...)."[326] Guided by the assumption of objectivism, scholars take it for granted that it is possible to calculate the social costs of monopolistic negative externalities imposed upon the social system that it is also possible to identify social welfare unequivocally. Under conventional regulation the authority attempts to make objective welfare determinations "from above".

326 Sowell, p. 203.

by assuming that it can eventually acquire omniscient knowledge about the conditions determining social welfare.

The idea of equilibrium in economics has therefore played a pervasive role in scholars' analyses of market interaction, by conflating positive and normative analysis. However, this particular understanding is fraught with methodological inconsistencies which are not readily realised. As a result, scholars become lured by the properties of the models drawn under the influence of this appraisal.

Klein warns against the excesses of conventional methodology in the following terms: "When conducting antitrust analysis it is crucial that economists do not conduct what I call 'blackboard economics.' The economist must not use abstract models, largely divorced from real world conditions, to reach economic explanations and policy implications. While the admonition that economists should 'get their hands dirty' and know the facts of the situation they are analysing may seem obvious and trite, much economic analysis, both the now dominant 'Chicago School' and the 'new' industrial organization varieties are often not connected closely enough to the events under investigation".327

The assumption of objectivism tacitly criticised by Klein leads those making the conventional appraisal to assume that it is possible to identify a "social optimum" against which reality can be matched. Thus, conventional analysis compares market relations to ideal normative standards, such as the Pareto standard, achieved in the Perfect Competition model, and condemns any departure as "failures". This appraisal fails to appreciate the limitations of comparing the world with a model which is perfect only on paper. Taking the conclusion that the former is "imperfect" provides no useful ground for practical policy-making. Comparing reality with theoretical models that depict utopian

327 Klein, "The Use of Economics ...", p. 419. Klein borrows the term from Coase, who uses it to criticise those systems "which live in the minds of economists but not on earth." See R. H. Coase, "The Institutional Structure of Production", in Essays on Economics and Economists, (Chicago: The University of Chicago Press, 1994), p. 5.

worlds is a futile and a misleading exercise, which will inevitably conclude that reality is imperfect, and requires some exogenous corrective intervention.

Firstly; it is a futile intellectual endeavour because it entails the fallacy of reaching a Nirvana that is impossible to attain in practice because of the costs involved. Certainly, Perfect Competition would not be an optimal standard for society to achieve if the costs involved were higher than the benefits resulting from the allocation operating in that situation.

These costs relate to the information required to make the standard operative and enforceable. Here, the antitrust authority in charge of maximising social welfare, faces an unsurmontable problem, for there is no way of passing tacit knowledge which can only be *subjectively* appraised by market participants to the antitrust authority. In fact, the problem of gathering information faced by antitrust enforcers makes it impossible even to know whether a given social situation is close to a "static equilibrium" point.

For this reason, the activity of antitrust authorities is devoted to making ad-hoc calculations of interpersonal costs and benefits, in the false expectation that such an exercise will somehow reveal social preferences. It is impossible to subject such social calculations to any accountability; therefore, they cannot be compatible with the rule of law, regardless of compliance with the forms of legal procedure required for its adoption. Indeed, such use of economic analysis is unwarranted, even under the methodological standards of conventional analysis, because it is not the purpose of a positive understanding of reality to deduce normative implications.[328]

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328 In his seminal essay *The Methodology of Positive Economics*, Friedman claims that the usefulness of positive models has little to do with the realism behind their premises: "it is beyond doubt that individuals in the reality behave and act in a way which does not have to correspond to the economic model so created. [Thus], a model is useful whenever it allows us to isolate factors and reasons that would otherwise be disguised; to understand how reality works, it is necessary to construct an idealistic world and then proceed to test each of its factors, to ascertain their individual effect on the total outcome". (Friedman, "The Methodology...", pp. 166-177.) Clearly, under this appraisal, arguing realism of the model's premises is unnecessary, since it does not purport to deliver any normative conclusions about such reality which is understood as a whole. It simply attempts to examine the elements of its construction in positive terms in order to approximate an idea of how such a reality would behave if certain variables changed.

Secondly, it is simply that equilibrium depicts a world of perfection, which is impossible to attain in practice. As we have indicated, the limitations of conventional analysis run deeper, stemming from the fact that such models convey no connection with the real world.

Antitrust scholars have attempted to circumvent this problem by drawing dynamic models of market interaction which overcome the most significant limitations introduced by the static approach to market relations. This has eventually led them to assume that even if perfection could not be reached, at least exogenous intervention could prove to be a second best solution, because it could improve social welfare by favouring the correction of instances where "reality" departed from the optimal equilibrium. However, even such dynamic conventional models fail to capture the nature of reality. Let us elaborate on this problem.

Certainly, antitrust scholars were aware of the idealism of optimal equilibrium analysis, which characterised Perfect Competition.[329] However, they were lured into the belief that drawing more "realistic" models about market behaviour could be done simply by describing ad-hoc situations outside the extreme "ideal" conditions of the Perfect Competition model. They relaxed its extreme constitutive assumptions: "perfect" information was made "assymetric" amongst economic participants; product "differentiation" replaced product "homogeneity"; infinite market participants were replaced by a few interacting firms. They assumed that in this way the dynamic market interaction of an imperfect world depicted in their models of imperfect competition would convey a better "direct" sense of reality, than any comparison made with the extreme static equilibrium of the Perfect Competition model.

329 For example, Scherer and Ross notice: "... Prices often hover closer to cost than one would predict from an analysis that takes into account only the fewness of sellers, ignoring co-ordination obstacles and long-run constraints. These *more subtle* structural and behavioural variables help explain why pricing performance in modern industrial markets has on the whole been fairly satisfactory despite significant departures from the structural ideal of pure economic theory". (F. M. Scherer and D. Ross, Industrial Market Structure and Economic Performance, Third edition, Houghton Miffin Company, Boston, 1990, p. 410.)

However, the revised model still contains a fundamental epistemological limitation from which conventional appraisal cannot escape. The nature of market behaviour is represented in the idea of evolution and change. In the words of Schumpeter: "Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action. (...) The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumer goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprises create."[330] This is an unescapable reality, for market information is not an objective asset capable of being equally seized and appraised by all agents. On the contrary, its nature is subjective, it is scattered throughout the system, and therefore interpreted differently by each market participant. Any decision in the market is adopted on the basis of conjecture and projections about what the future will bring. Expectations, by definition are untested plans whose reliability depends upon execution. Failure or success in these predictions will encourage economic agents to change or maintain their ongoing course of action, in order to deal with future similar situations.

In the next chapter we will explain how evolution and change follows or from this process, and how entrepreneurs seek to minimise the losses that could result from failures in planning their activities. At this point, it is sufficient to note that any policy which attempts to maximise social welfare should take note of this simple caveat: adherents of antitrust fail to understand the crucial role that business expectations play in framing evolution and change under real market processes. As tentative appraisals of the future, the expectations which embody the essential elements necessary for understanding competition in the real world and which are absent from the neo-classical models are real time and sheer ignorance. Antitrust theory bases itself on the expected monopolistic behaviour of firms under the assumption that policy-makers, as omniscient outsiders, can

330 Schumpeter, Capitalism, Socialism and Democracy, pp. 82-83.

properly appraise the complexity of the relevant information which market participants produce and possess.

This chapter has demonstrated how, by sticking to an unfit appraisal, policy-makers end up making unwarranted normative conclusions. Antitrust theorists cannot help but regard these practices as simple devices used by firms to prevent rivalry amongst them, and this is assimilated to restrictions on competition. Indeed, competition is defined in terms of the number of effective market participants.

However, competition in the real world is much more than that. Competition, in the subjective sense, relates to the possibility that entrepreneurs can be alert to new opportunities or valuable information which they had previously overlooked. By definition, the activity has to be related to a new sector, product, technique, geographical area, use, skill, attribute or particularity that entrepreneurs consider valuable in a subjective sense, because it will presumably bring some benefits, which are measured by their personal goals.

Under this alternative concept, the number of participants is irrelevant; indeed, under this alternative paradigm it is impossible to define market structure with reference to products or geographical areas. In a sense, every firm has a unique advantage that enables it to exist in the market, every firm is a "monopoly" because it has discovered a hitherto unexploited opportunity. Under this appraisal, the main question is how to prevent current regulation, social customs, legal rules and other institutional arrangements from unduly restricting entrepreneurs' alertness. The problem is how to ensure a minimum predictability of social rules, and government action. It is necessary to control administrative discretion, which in the case of antitrust policy is impossible, since enforcement inevitably strikes a balance between interpersonal comparisons according to the unaccountable judgement of the decision maker. Considering the history of abuses of power in the Latin American public policy, and its stalling effects on the growth of entrepreneurship and innovation, it is clear that these questions need to be addressed.

These considerations are essential for understanding the weak epistemological foundations of antitrust theory. Under such theory it is impossible for the analysi to reach meaningful positive conclusions about the conduct of entrepreneurs, who would otherwise support policy-making. Indeed, what these models depict is not the conduct of any particular person, or even their likely conduct, but the expected outcomes of *anonymous* forces whose interaction depends on the conditions postulated in the respective model. These models cannot therefore "predict" any future market outcomes, since the ideal conditions they impose are unavailable at any instance in reality. Thus, no empirical evidence can *really* prove whether markets "fail": at best, a positive conventional analysis provides *tentative* explanations of *past* market behaviour. Any legal doctrine developed within these premises will also be tentative and weak; it will be a poor foundation on which to base stable legal standards suitable for judging the conduct of entrepreneurs.331

Equilibrium is a poor mechanism for understanding how such reality works, because it requires the analyst to take away the basis of reality, which is evolutive and

331 The problem is indeed a fundamental one, and deals with our beliefs about the value of empirical evidence and the positive method of providing "support" for our explanations about "*human behaviour*". This is a question that can only be challenged on epistemological grounds, where the critique of the positivistic method in social sciences is rooted. Individuals are neither things nor animals, therefore they behave purposely; they do not necessarily act reactively to external stimuli along certain patterns of conduct. As a consequence of this basic and obvious premise, social scientists are forced to regard human behaviour with different methods of enquiry from those currently used by positive scientists to measure and predict patterns (laws of behaviour) found in natural events. As Frank Knight claimed: "(...) man's relations with his fellowman are on a totally different footing from his relations with the objects of physical nature. [For this reason, economics should] give up, except within recognized and rather narrow limits, the naïve project of carrying over a technique which has been successful in the one set of problem and using it to solve another set of a categorically different kind". See F. Knight, "The Limitations of Scientific Method in Economics", in Ethics of Competition, (New York: Books for Libraries Press, 1935), p. 147. It is at least necessary to acknowledge these weakensses in the positive method of enquiry of explaining human behaviour, in order to know what to expect from empirical data. Milton Friedman was particularly cautious about this, as he acknowledges in his *Methodology of Positive Economics*. He argues: "Economics as a positive science is a body of tentatively accepted generalizations about economic phenomena that can be used to predict the consequences of changes in circumstances. *Progress in expanding this body of generalizations, strengthtening our confidence in their validity, and improving the accuracy of the predictions they yield is hindered not only by the limitations of human ability that impede all search for knowledge but also by obstacles that are especially important for the social sciences in general and economics in particular, though by no means peculiar to them*". (Author's italics) (M. Friedman, "The Methodology...", p. 177)

changing, for the sake of enabling the models to fulfil their "predictive" role on paper. Conventional economic analysis appears to be more concerned with demonstrating how economic models work, rather than explaining how reality behaves.

This is not to say that equilibrium is not useful or interesting as a mental construction. Unquestionably, its theoretical expressions can only be understood after exercising great care and advanced mathematical skills. Indeed, they may be useful for dealing with very exceptional cases where the analyst holds all the relevant information involved in the appraisal. However, in open-ended realities, such as those featuring markets, where information changes and evolves constantly, this perception is clearly irrelevant. Such models are useless for defining solutions aimed at improving the welfare of society in the real world, simply because such a perfection cannot be found on paper. Nevertheless, despite all these drawbacks, scholars continue to overestimate the role of the mental constructions used to understand economic reality.[332]

In conclusion, the dual assumption of perfect-objective knowledge and equilibrium entail two essential shortcomings in the analysis of market phenomena and competition processes. First, it attempts to explain the process of competition under conditions where the process has ceased to exist, which presents the observer with a contradictory or at least futile dilemma: that of examining phenomena denied by definition. If information were "perfect" and readily available, why would firms bother to compete for it? If it were not, why would antitrust agencies attempt to make it "perfect", if by doing so they discourage firms from competing? Second, even if we attempted to explain such phenomena *indirectly*, in comparison with an idealised image of a world where competition is "perfect", the objective nature of the information required for the model to be meaningful would be inconsistent with its subjective nature, in reality. Therefore, scholars constantly misinterpret the role of empirical evidence, and thus indirectly misinterpret the entire process of market interaction.

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332 As Rizzo claims: "Whether we view equilibrium in [dynamic terms] or take a more conservative [static] position is purely a matter of heuristic and analytic convenience. Indeed, the notion of equilibrium, (...) is only a mental tool without any direct operational significance. Depending on the purpose at hand we may use either (...) conception". (Rizzo, Disequilibrium..., p. 6.)

These caveats open an epistemological discussion which it is necessary to address here. Indeed, policy-makers should at least retain an element of connection with the reality which is lost in conventional analysis. Even accepting that equilibrium is achievable (or something that approximates to it is possible), *this way of thinking* does not satisfactorily explain how the economic system reaches such a point. The models simply assume that equilibrium is "there", already achieved within the model by perfectly informed entrepreneurs. It does not tell how imperfectly informed entrepreneurs conduct themselves in order to gather such information, thus pushing the economic system into a position of equilibrium. As Richardson argues, "by neglecting the whole problem of information,.the perfect competition model condemns itself not only to unrealism but to inadequacy even as a hypothetical system. It is no defence to appeal, moreover, to the analogy of mechanical statics which, though neglecting friction, can still identify the equilibrium position of a system of forces, for we cannot demonstrate that economic systems have such positions of rest without reference to expectations and information which could not be presumed to be available in the absence of restraints".[333]

The only way of overcoming these difficulties is to turn the appraisal upside down, and switch the paradigms of approximation to reality. Instead of assuming that reality is failing compared to a model of perfect competition, where no restrictions on competition exist, we should appraise reality through an approach based on models that incorporate predictability, the element which entrepreneurs need in order to achieve a position of equilibrium. This approach draws economic models which are based on the information they make available to market participants. Under this appraisal, the perfect competition model has no special normative status; it is simply a model depicting an institutional environment where no restrictions on trade exist, but where business predictability is zero. Models that depict trade in environments where predictability is positive would represent a more meaningful standpoint from which to appraise real markets, and in particular, the conduct of entrepreneurs.[334]

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333 Richardson, Information ..., p. 69.

334 G. B. Richardson, "The Theory of Restrictive Trade Practices", 17 Oxford Economic Papers (1965), pp. 434-435.

In other words, we shall attempt to outline an institutional approach that deals with the more meaningful dilemma of confronting feasible institutional frameworks. Obviously, this leads us into another sphere, namely, that of comparing *real* institutional frameworks and assessing how capable they are of delivering real effects. The objective, then, is to conceptualise an abstract order that could promote competition and predictability amongst economic agents in conditions of unavoidable *imperfect* limitations on human knowledge.

CHAPTER IV.- TOWARDS A NEW UNDERSTANDING OF MARKETS, ECONOMIC ORGANISATION AND REGULATION.

"The limitations of the concept [of perfect competition] in dealing with conditions of persistent and imperfectly predicted change will not be removed until economics possesses a developed theory of change."

(G. Stigler, "Competition" in The New Palgrave in Economics: A Dictionary of Economics, Vol. 1, p. 535.)

"This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in."

(Schumpeter, Capitalism, Socialism and Democracy, p. 83.)

"The coordination of economic activities, of course, is (...) what economics is overwhelmingly about."

(B. Loasby, Equilibrium and Evolution, p. 9.)

In order to ground an institutional proposal for promoting competition, it is necessary to lay down an alternative understanding of market interaction. This chapter presents such theoretical framework by incorporating the subjective basis which pervades social phenomena. Compared with a conventional appraisal, which represents the behaviour of firms as a mere endeavour of selection amongst maximising options performed with full knowledge, this alternative approach portrays business activity in quite different terms. It is presented as an ongoing exercise of speculation about the future, in which entrepreneurs make conjectures and projections about the use of social resources; in other words, it is as an exercise pervaded by sheer ignorance, which is a far cry from the neo-classical assumption of omniscience. It is the subjective nature of these conjectures and projections that provides markets with their distinctive dynamism, wholly absent from conventional neo-classical models. The perception of markets through the lens of subjectivism could enlighten us about the intentions of entrepreneurs and their activities as rivals and partners in the market process, thus providing a more reliable yardstick for the development of normative legal standards in judging their actions.

The subjective analysis of market relations and its implications in the formulation of public policy for the promotion of competition are addressed in this chapter as follows:

The first section provides an overall view of the nature of the institutional paradigm upon which we base our analysis of markets and competition. This section explores how social institutions are inextricably linked to an evolving reality, and how within the uncertainty created by such an ongoing process institutions provide some predictability for economic agents, thus fulfilling a crucial social role. We will explore how changing the "economic order" also opens the way to an adaptable but nevertheless predictable rule of law. Under this appraisal, individuals confine their uncertainty to behavioural rules which are mutually agreed and which evolve into general principles and comprise the substratum of a stable –yet·orderly changing– legal order.

In terms of policy-making, this appraisal reveals that individuals are better equipped to discover socially valuable knowledge compared with governments. Hence, it questions the traditional role of governments by challenging the traditional notion of "social welfare" guiding policy action. In an open-ended world, governments cannot seize all the relevant information necessary to achieve "public interest". Therefore, cannot be a question of choosing the notion of social welfare that better fits "public interest" into the cage of government goals. Rather, social welfare occurs through individual interaction, albeit understood in radically different terms, in contrast with the conventional notion of welfare.

These preliminary ideas are necessary to set the stage for understanding how social rules and practices which emerge from market interaction are embedded in it, in the sense that they are indispensable for the materialisation of exchanges and trade.

The question that follows from this is a closer examination of how competition is related to co-operation, and how improvements of competition may enhance social welfare. Is competition contradictory to co-operation achieved through business practices and arrangements which are considered "anticompetitive" under conventional antitrust? In order to highlight why this is not the case, this chapter presents competition as the constant endeavour to seek valuable information, achieved through the development of routines and social conventions which eventually materialise into customary rights.

Competition enables market actors to reappraise these routines and conventions in order to adapt them to unforeseen circumstances.

The second section explains these general concepts in more detail with reference to market functioning. It shows why firms seek to co-ordinate their activities, and why such co-ordination is not necessarily harmful but may well be regarded as the essential expression of institutional efficiency which allows the system or rules to unfold and convey valuable information which entrepreneurs require to make their production plans.

This view provides a blueprint for making a different normative judgement from that embodied in antitrust policy, since many forms of co-ordination of information, which are inevitably branded as "anti-competitive" under the latter, appear as efficient means of discovering and conveying useful information hitherto unknown. These considerations provide a conceptual basis for examining the likely negative implications of enforcing antitrust policy on many of the corporate structures and strategies developed and practised in Latin America.

Finally, the last section puts forward a policy proposal for promoting competition in Latin America. This proposal focuses on enabling entrepreneurs clear spaces to exploit their alertness to profit opportunities. A competition advocacy agenda to be implemented in the context of Latin American socio-cultural institutions is devised.

1.- THE DEFINITION OF PUBLIC INTEREST UNDER OPEN-ENDED ECONOMIC SYSTEMS.

1.1.- Disequilibrium as a heuristic tool for visualising markets.

In *Capitalism, Socialism and Democracy*, Schumpeter observed: "The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process."[335] In essence, this is a "Creative Destruction" process, which entails a process of "industrial mutation" that revolutionizes the economic structure *from within*.

335 Schumpeter, p. 82.

destroying the old one. In this process, "old concerns and established industries, whether or not directly attacked, still live in the perennial gale. Situations emerge in the process of creative destruction in which many firms may have to perish that nevertheless would be able to live on vigorously and usefully if they could weather a particular storm. Short of such general crises or depressions, sectorial situations arise in which the rapid change of data that is characteristic of that process so disorganizes an industry for the time being as to inflict functionless losses and to create avoidable unemployment."336

Notwithstanding, while Schumpeter accurately described the dynamic nature of market functioning, he did not advance an elaborated theory of markets explaining how the creative destruction process comes about. Rather, he developed an intuitive appraisal of what he regarded to be an obvious condition of markets. In this perspective, his views were indeed an important departure from the mainstream on markets and firms. As we have indicated above, no serious scientific effort emerged to explain this "dynamic" portrayal of markets at the time, due to the formalism which had pervaded economic science since the 1930's as a result of the use of "heuristic equilibrium", in which was grounded the understanding of social phenomena, and in particular, market interaction.337

In order to develop an alternative explanation of the nature of markets it is necessary to overcome the limitations of equilibrium as a heuristic model in order to appraise social interaction and market functioning. In this sense, O'Driscoll and Rizzo visualise an "evolving" market order through the idea of "pattern co-ordination".338

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336 Schumpeter, p. 90. Perhaps the use of the adjective "destruction" impinges upon the visualisation of markets, portraying them as something chaotic; yet this is far from the truth. Indeed, markets follow a certain logic under the guidance of abstract rules, thus creating an "economic order". In this context, open-ended systems define an "order" which is incomplete, but nevertheless bound. This is the case in markets where interaction is guided by the interaction of the many, but does not follow anyone's particular ends. Notwithstanding the absence of external intervention, markets achieve an order which is built from within. This process is best described by the Greek word "catalaxia", which conveys the idea of an arrangement which organises its elements in such a way so as not to constrain anyone. See, Hayek, Law, Legislation and Liberty: Rules and Order, Chapter 2.

337 See Chapter 3, section 1, above.

338 O'Driscoll and Rizzo, pp. 85-88. Pattern co-ordination emerges from the perceived weaknesses of Hayek's notion of equilibrium as "plan co-ordination", as presented in his seminal work

Reality is comprised of a complexity of facts that belong either to a "class" events or "unique" events. The first group corresponds to events which can be perceived to follow a repetition or "pattern" over time, whereas the second is comprised of events which are perceived as not being dependent on time and which are therefore not repeatable.[339]

Thus, pattern co-ordination exists whenever individuals' plans are co-ordinated with their class features, *even if their unique aspects fail to mesh*. The fact that unique aspects do not co-ordinate with equilibrium is, according to this notion, not a weakness in the analysis but as strength because it allows time and uncertainty to be dealt with satisfactorily within the model.[340] The notion of pattern co-ordination provides us with an explanation of the "spontaneous" way by which institutions, such as legal rules, emerge. Conventions emerge to co-ordinate individual plans with respect to class features which are perceived to occur repeatedly. Similarly, the singularity of "unique" events explains why endogenous changes occur in the system that are necessary to adapt to unknown future contingencies.

Economics and Knowledge. 4 Economica, [new. ser., 1937], reprinted in Individualism and Economic Order, (Chicago: The University of Chicago Press, 1948), 33-56. Under Hayek's notion, the remuneration that could potentially arise from trade exchanges creates expectations for those who feel they could gain something from trading. To Hayek, trading is possible whenever individuals possess mutually compatible expectations about each other and about the external data. (Hayek, "Economics...", pp. 41-43.) However, some of these expectations will be disappointed as the circumstances frequently prove to be different from individual beliefs. Therefore, certainty about market conditions is essential for lowering the number of disappointed expectations. It is the task of competition to show which of these expectations are unfounded, and of the legal system to minimise the number of "underserved" failed expectations. Also, M. Rizzo, "Hayek's Four Tendencies Toward Equilibrium", Cultural Dynamics [1990]: 12-31 and M. Rizzo, Equilibrium Visions, Economic Research Reports, R.R. #91-58, C.V. Starr Center for Applied Economics, Department of Economics, New York University, New York, 1991. These critiques rely on the incapacity of Hayekian co-ordination equilibrium analysis to adapt to real time.

339 "Class" events are ascertainable through certainty or through the calculation of probabilities: in the first case, the predictor asserts that a given event will occur; in the second case, the predictor associates a compound set of mutual class events with a series of weightings. O'Driscoll and Rizzo put forward an example that differentiated the two ways of anticipating class events: the use of the certainty method allows the prediction that there will be a police patrol in a given place and time; the probabilistic method, by contrast, allows the calculation that the probability of such a patrol may be 0.4, a gang brawl 0.2, or a delivery of illegal narcotics 0.4. In both cases, the class condition of the events predicted does not change; what changes, however, is the way in which they are predicted. (O'Driscoll and Rizzo, pp. 76-77)

340 O'Driscoll and Rizzo, pp. 85, 87.

The fact that social interaction is a complex evolutionary process triggered by the sheer ignorance of its participants does not mean that social systems lie in chaos. Order results from the recognition that changes in the system and the ascertaining of future events to some extent are bound by the level of information available today. If there were no certainty about the future whatsoever, it would make no sense to make plans to match and co-ordinate activities in the marketplace.

To explain how individuals and firms behave in the disequilibrium or "pattern co-ordination" that characterises the open-ended market order, Kirzner developed his concept of "entrepreneur" in his seminal work *Competition and Entrepreneurship*.341 This concept attempts to overcome the rigidity of the neo-classical *homo economicus* in economic analysis. The notion of "entrepreneur" provides a useful connecting thread between all these elements. The entrepreneur acts as an *arbitrageur* led by profit-making opportunities constantly arising from gaps in the knowledge of the market as a whole. He must be "alert" to discover new opportunities that allow him to move ahead and outdo his competitors. Firms exploit these profit opportunities, thus creating new knowledge, favouring exchange possibilities and enhancing the co-ordination of individual plans and social efficiency. In the words of Kirzner: "... Each entrepreneurial discovery represents alertness to a hitherto unperceived interpersonal opportunity –an opportunity that depends on the co-ordinated plans of two separate individuals. As this "general" equilibrating process proceeds by competitive entrepreneurial alertness, it identifies more

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341 I. Kirzner, Competition and Entrepreneurship, (Chicago: The University of Chicago Press, 1973) It should be noted, however, that Kirzner has never fully acknowledged disequilibrium as a heuristic tool. His notion of the economic system is one which is always moving towards equilibrium, as entrepreneurial action narrows the gap of disequilibrium created by the awareness of business opportunities. In this issue, his views appear more moderate in contrast with those inaugurated by George Shackle, who advocated a radical departure from any heuristic appraisal of reality based on the idea of equilibrium. Nevertheless, Kirzner's views brought an important insight on the limitations of the neo-classical appraisal to explain market processes. On Shackle's radical disequilibrium, see L. M. Lachmann "Professor Shackle on the Economic Significance of Time" in Capital, Expectations and the Market Process: Essays on the Theory of the Market Economy, Institute for Humane Studies, Sheed Andrews and McMeel, Inc. Kansas City, 1977, pp. 81-93.

and more uncoordinated situations, while spreading the information perceived by entrepreneurial alertness among wider and wider circles in the market".[342]

These opportunities do not refer exclusively to price gaps, but also, to the vast array of value exchange mechanisms that enable entrepreneurs to gain such advantages in the market. Therefore, in contrast to the conventional appraisal, Kirzner's notion of competition refers to any factor which gives a business advantage to a market participant *vis-à-vis* their actual or potential competitors. It comprises new products that are worth producing; new methods of producing known products; new uses for old products; new sources of supply for given input services; new attitudes of known suppliers to existing input services; new distribution, marketing and selling techniques, and so on. In general, these refer to either uncoordinated or unforeseen gaps of information. Intuitively, these gaps "tell" perceptive entrepreneurs that certain techniques will prevail or that others will replace them.

In order to seize market opportunities, however, entrepreneurs must necessarily avoid the waste resulting from mistakes they could make with false or incomplete information. To do so, they have to build reliable conjectures about what to expect from other fellow entrepreneurs. Co-ordination appears necessary to gain knowledge which would make them better off. Social wealth is also created since this newly acquired knowledge serves the needs of society more effectively.

However, it would be impossible to achieve these goals if the system is not reliable enough to preserve entrepreneurs' expectations concerning their productive activities. To allow markets to function adequately, it is essential for the mechanism created to fulfil the expectations of those sufficiently astute to discover hidden opportunities and thereby create new knowledge. Thus, for Cordato, the efficiency of the social body "can be judged by the extent to which [it] encourages individuals existing in a social context to pursue their own goals as consistently as possible".[343] To achieve this the prerequisite is

342 Kirzner, Competition and Entrepreneurship, p. 222.

343 Cordato, Welfare... at 62. Austrian-institutionalist scholars debate on the substratum of institutional efficiency. Kirzner, for example, contends that efficiency is achieved through co-

that markets must provide a minimum stability against the uncertainty that could undermine such expectations. This is the function of legal rules: to ensure that the largest possible amount of undisclosed information emerges from the dark and that those who value it most can gain access to it. We will now focus our attention on this question.

1.2.- The role of government regulation in the open-ended market order.

a) Understanding public interest in open-ended economic systems.

The heuristic model of pattern co-ordination allows us to define an alternative appraisal to the understanding of public interest which is embedded in legal rules in the context of open-ended systems.

In this context, *public interest* is not an abstract formula of social welfare devised in the mind of a superior "central planning" entity. Instead, it embodies the mutual perceptions and collective wants of many individuals, thus providing the concept with a truly social sense. In the context of market transactions, "institutional" public interest is not idealised under an abstract welfare calculation of efficiency (as for example, the Pareto Criterion, or the Kaldor-Hicks) but is realised through an aggregate "opinion" expressing the particular way that individuals find most acceptable for co-ordinating their activities.

Under the institutional paradigm, the social efficiency standard which enables the observer to judge the performance of "pattern co-ordination" does not depend on how resources are allocated but on how much the social system co-ordinates scattered data

ordinating the actions of market participants, while Cordato contends that co-ordination is a secondary goal to facilitating the attempts of market participants to attain their particular goals, although that may conflict with the overall co-ordination of markets. (Cordato, Welfare..., p. 62). It seems that this discussion does not reveal a contradiction of postulates, since in both cases social interpersonal goals which serve as a reference for social efficiency (i.e. Pareto optimum) are rejected, and attention is placed on the individual condition of market participants to define an institutional formula of social efficiency. Instead, it appears that the question posed is a matter of emphasis, one can regard efficiency from the viewpoint of the objectives of the social body (i.e. Kirznerian co-ordination of markets) or regard efficiency from the perspective of the participants individuals, as Cordato proposes.

and information which is subjectively perceived by different entrepreneurs according to their own learning experiences. The distinction was initially emphasised by Hayek in his 1937 paper *Economics and Knowledge*,[344] later followed by Richardson's works.[345] Social efficiency is only feasible if entrepreneurs can co-ordinate their activities to the maximum and exchange available information which enables them to meet their goals. As Hayek indicated, in what has perhaps become his most frequently quoted sentence in economic science: "The economic problem of society is thus not merely a problem of how to allocate 'given' resources, if 'given' is taken to mean given to a single mind which deliberately solves the problem set by these 'data'. It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality".[346]

To understand the nature of the problems that individuals face in the market, consider the situation where producers are all hit by an increase in demand. How much should they increase production by? The information found in other firms' investment decisions which would be necessary for calculating optimal investments is not readily available to anyone. Entrepreneurs may guess, of course, but these guesses are dependent upon the guesses of other firms, which would seem to lead into an infinite regression and sheer uncertainty.[347]

Markets possess an inner condition of pattern co-ordination or institutional efficiency which brings about a correspondence between the expectations of each

344 F. A. Hayek, "Economics and Knowledge", IV Economica [new ser., 1937]: 33-54.

345 The allocation of resources is essentially a problem involving the decision of each individual in the social system, whereas coordination is the key to understanding how different plans and pieces of knowledge are separately held in the mesh of a social setting. Economic theory has not as yet clearly acknowledged the full implications of this different appraisal, being concerned almost exclusively with the individual level. See N. Foss, "Austrian and Post-Marshallian Economics: The Bridging Work of George Richardson", in Economic Organization, Capabilities and Co-ordination, Routledge, London, 1998. In this work, Foss explains the close intellectual strands of Richardson's work and Hayek's.

346 F. A. Hayek, The Use of Knowledge in Society, pp. 77-78.

347 This is exemplified in Keynes's famous Beauty Contest. See Chapter 3, section 1.2, above.

participant through a learning process. This way of co-ordinating individual actions secures an effective utilisation of the knowledge and skills of the members. Later, we will explore how market arrangements provide the necessary web of information to reach a solution to this problem of uncertainty.

In this perspective, the existence of externalities lessening "public interest" in the conventional sense is, by definition, denied. In the context of market relationships, as Huerta de Soto explains, the fact that entrepreneurs fail to see or ignore the existence of profit opportunities leads them to err. But with this approach, such *errors* do not necessarily entail a negative bias, as the notion of market *failures* would, because their existence provides an opportunity to profit for more alert entrepreneurs: "It is precisely the existence of [sheer entrepreneurial errors] that generates pure entrepreneurial profit".348 Therefore, the presence of errors does not diminish the efficiency of the open-ended system, if individuals are free to correct them.

Hence, public interest is not related to the protection of a value which lies "outside" the will of those actually involved in the transaction concerned. It is more related to the generation of valuable information, achieved through a learning process which demands both co-ordination between entrepreneurs and competition so that they may seize information gaps and reveal "uncoordinated" business opportunities. Its existence does not depend on the specific outcomes achieved at one given stage. Instead, public interest depends on the fact that present and prospective co-ordination is improved as much as possible, because it is then that the hidden value of social information will materialise and satisfy the needs of those who "become aware of it".

348 J. Huerta de Soto, La Methodenstreit..., p. 58. This trial-and-error process inevitably disappoints some expectations. Responses to the differences between the expected and the actual results will lead to fewer frustrated expectations in the next round. Hence, there will be some expectations that the market order will inevitably fail to fulfil. (F. A. Hayek, Law, Legislation and Liberty: The Mirage of Social Justice, (Chicago: The University of Chicago Press, 1973), chapter 10.) Nevertheless the process has created new knowledge, although in a negative sense, by indicating what course of action should be avoided. In this way, markets fulfil a social role in disclosing hidden information, even if by doing so some individual expectations have to be disappointed. Market order guides individuals' actions and brings about a correspondence between the expectations of the people that actually succeed, while inducing unsuccessful ones to sharpen their forecasts in future transactions.

b) The role of legal rules in the transmission of information in open-ended economic systems.

A redefinition of public interest inevitably leads to a reappraisal of the very purpose of social and governmental rules in the social system. Thus, the legitimacy of "law", from an institutional perspective, is inevitably tied to the capacity of these rules to convey valuable information to economic agents, which enable them an easier or more effective plan co-ordination. Hence, what makes public interest "public" from the standpoint of legal science is not dependent on whether the legal rule is enacted by the authority, or whether it is agreed according to certain procedures regarded as legitimate, as legal positivists would contend.[349] It is whether the rule favours or impedes social co-ordination.[350]

Therefore, under this definition, "legal" rule possesses a broader meaning. The definition encompasses those rules enacted under formal mechanisms as well as customs, conventions and routines developed out of social interaction, regardless of whether an official law-making body formally approves them.

The chief feature of legal rules their embodiment of the social consent, which is their ultimate source of coercion. That consent is not found on principle but in the practical role they play in conveying information valuable for productive activities. This

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349 Hart, "Positivism...," pp. 593-629.

350 In his work *The New Social Contract* Macneil underlines the failure of positivistic legal thinking to distinguish between "official law", and "real world" contractual needs. It seems that perceiving the law in "legalistic" terms, that is, as merely consisting of "official" sources, has serious limitations in relation to the need to adapt human exchanges to unforeseen events. (I. R. Macneil, The New Social Contract: An Inquiry into Modern Contractual Relations, Yale University Press, London, 1980, p. 5.) True, -Macneil contends- "official law" is an important component of all contractual relations, yet the significance of contracts extends beyond its boundaries: "Contracts are about getting things done in the real world" (p. 5) Hence, "official" law should not be confused with the underlying social relations that it aims to regulate. By contrast, law-oriented definitions narrow our perspective because they force us to think about law, thus neglecting the underlying relations: "If we wish to understand contract law, we must think about exchange and such things first, and law second" (p. 5)

explains why rules must adapt to changing circumstances; they may otherwise become obsolete and loose their informational role.

According to North, "institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction (...) Institutions reduce uncertainty by providing a structure to everyday life". They provide a reference framework which makes the future less uncertain, thus enabling market exchanges.[351] Thus, overcoming uncertainty in order to encourage entrepreneurs to make investments is related to a capacity to establish effective institutions which provide the stability needed to predict possible outcomes and the flexibility to adapt to change. Such effectiveness is inextricably linked to the extent to which individuals perceive these institutions as binding and capable of meeting their changing needs.

The informational role of institutions has a lot to do with a legal notion formerly neglected in the conventional appraisal of legal rules, namely, "legal certainty as expectancy" or "certainty as expectations".[352] The rule of law emerges as a result of a process where entrepreneurs match their mutual expectations in their interactions over time. An entrepreneur may succeed in communicating his intentions to others by simply behaving similarly under similar circumstances. Conversely, others may build up firm expectations by relying on their own past trading experience, or by basing their judgement

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351 D. North, Institutions, Institutional Change and Economic Performance, (Cambridge: Cambridge University Press, 1990), p. 2.

352 This notion was eclipsed for a long time due to the rise of legal positivism's emphasis on a formal approximation to the source of legal rules' enforceability; yet, this is by no means alien to legal science. On the contrary, its significance has been long acknowledged, as Leoni states: "Many Western countries, in ancient as well as in modern times, have considered the ideal of individual freedom (the absence of constraint exercised by other people, including the authorities) essential to their political and legal systems. A conspicuous characteristic of this ideal has always been the certainty of the laws". (Leoni, p. 93.) It grounds legal certainty on the basis of a series of rules spontaneously accrued in the decisions of individual cases, and later ascertained by judges over the centuries and generations. "Certainty" is related to the need for individuals to know the likely outcome of their activities in advance. For this reason, this concept embodies the "aggregate knowledge" of cumulative decisions solving problems along a similar pattern, thus giving economic actors relying upon the alignment of their conducts and long-term plans a rule embodying a tested solution. As Leoni states, "general regulations laid down in due time and made known to all citizens make it possible for them to foresee what will happen on the legal stage as a consequence of their behaviour". (Leoni, p. 72.)

on the reputation of a given entrepreneur, reflecting the trading experience of other entrepreneurs. Alternatively, they may resort to contractual means to ensure a willingness to comply with the expectations created. If contracts are unavailable for some reason, then parties may simply align their conduct with that of other entrepreneurs, on the basis of what they expect from them.

In this perspective, the particular wording or written form of the rule may indeed have some influence, but this is not the ultimate reason for the willingness of those subject to it, to comply with its mandatory effects. History gives us many instances of how institutions are related to the *effective* constraints imposed upon entrepreneurs, which emerge not from the conviction that they are dictated or enforced by the legitimate authority, but from the conviction that they must possess some practical use. These constraints may result from the enforcement of an official rule, but may also evolve from the traditions and customs to which the legal system may or may not attach official recognition.353

353 History gives us examples where these customary rules were more effectively enforced by groups sharing common interests than the numerous rules contained in codes and legislation throughout the world. In Rome, for instance, Cato the Censor, cited by Cicero, highlighted the superiority of Roman customary rules as compared with other systems. In his words, "the political systems of other countries had been created by introducing laws and institutions according to the personal advice of particular individuals like Minos in Crete and Lycurgus in Sparta, while at Athens, where the political system had been changed several times, there were many such persons, like Theseus, Draco, Solon, Cleisthenes ... Our state, on the contrary, is not due to the personal creation of one man, but of many; it has not been founded during the lifetime of any particular individual, but through a series of centuries and generations. For he said that there never was in the world a man so clever as to foresee everything and that even if we could concentrate all brains into the head of one man, it would be impossible for him to provide for everything at one time without having the experience that comes from practice through a long period of history". (Cicero, De Republica ii, 1,2. Quoted by Leoni, p. 88). Most of the Roman rules on private law were not dictated by a superior authority, but emerged slowly from social interaction: these rules were embodied later in the code provided by Justinian *Corpus Juris Civilis*. Private Roman law, which the Romans called *jus civile*, was kept beyond the reach of legislators. The various leges, plesbicita and Senatus Consulta were reserved for public law matters relating to the functioning of political assemblies. The fact that written law was reserved to matters *quod ad rem Romanam spectact*, and that Romans relied on customary law for their economic relations did not diminish the predictability that Romans enjoyed in business and private matters, as evidenced by the enormous development of the Roman economy. Similarly, in the Common Law system the judges had an inclination to remain as spectators rather than actors in the law-making process. (Leoni, pp. 81-86) Finally, it is illustrative that the later Napoleonic Civil Code was a compilation of rules dictated under the *Ancient Regime*, which was, in principle, intended to make the former accessible to the layman, not to overrule him. (J. Merryman, The Civil Law Tradition. An introduction to the Legal Systems of Western Europe and Latin America, Stanford University Press, Standford, 1969, p. 100.)

In this sense, the rule of law comprises institutions which are already endogenously embedded in the expectations of social actors. To this extent, it encompasses, conditions and shapes the economic interaction that takes place within a complex web of express and tacit rules of behaviour accepted by all. Unlike the conventional approach, which regards legal rules as "orders" imposed upon social interaction from the outside, our appraisal regards them as the outcome of cumulative market interaction, following patterns where utility maximisation is difficult or costly.[354] Thus, like the uncertainty they aim to eradicate, institutions are *endogenously* created.[355]

Hayek describes the informational role of legal rules as follows: "Although legislation can certainly increase the certainty of the law on particular points, I am now persuaded that this advantage is more than offset if its recognition leads to the requirement that only what has thus been expressed in statutes should have the force of law. It seems to me that judicial decisions may in fact be more predictable if the judge is also bound by generally held views of what is just, even when they are not supported by the letter of the law, than when he is restricted to deriving his decisions only from those among accepted beliefs which have found expression in the written law".[356] This is more likely to happen in those legal systems where no single individual has control over the law-making process, but where decisions about the law are left to a multiplicity of decisions that reproduce evolving patterns of social behaviour regarded as "fair" over time.

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354 K. Vaughn. Institutions as the Source of Catallactic Order, George Mason University, paper presented at the Austrian Economics Colloquium, Department of Economics, New York University, October 1996.

355 According to Choi, individuals idealise the reactions they expect from mutual interaction in an approval-seeking and disapproval-avoidance pattern. They formulate idealised categories of the conduct that each one expects from the others, and the conduct that he thinks others should expect from him. (Y. B. Choi, On Neglected Opportunities and Entrepreneurial Discoveries, Paper presented at the Austrian Economics Colloquium, Department of Economics, New York University, April 1997, p. 6.)

356 Hayek, Law, Legislation and Liberty: Rules and Order, p. 116.

Hence, these principles are not devised by any particular authority at a given point in time, but embody the aggregate wisdom of past experience.[357] Legal frameworks evolving from marginal additions are less prone to change in the long-term; therefore, the certainty resulting from these systems is superior to that in systems where the certainty of the law relies only upon the wording of the legal instrument concerned. As Buckland states, the law is not represented by codes, statutes or other legal means, but by "a set of principles gradually evolved and refined by a jurisprudence extending over many centuries, with little interference from a Legislative body".[358] It is on these general principles that entrepreneurs base their expectations, and ultimately their decisions about whether to invest or not.

Legal rules are necessary tools which enable market actors to overcome their ignorance and, in particular, their ignorance about the future. Legal environments which are characterised by regular decision-making are prone to improve the predictive expectations of individuals of the conduct of other market participants.

These considerations enable us to see that it is not by seeking particular utilitarian goals but something else that allows us to grasp the essence of a rule of law in an evolving social setting. That something else is related to the *informational* function that it plays in conveying disperse, changing knowledge to market participants.

Let us delve more deeply into the essence of this evolving process that eventually leads to the creation of customary legal rules with a clear informational role. It is from this process that legal rules evolve and consolidate into a "corpus" of settled routines acknowledged by society as binding and legitimate. Their legitimacy lies in the anticipated

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357 See M. Rizzo, "Rules versus Cost-Benefit Analysis in the Common Law", 4 The Cato Journal [1985]: 865-884.

358 W. W. Buckland, Roman Law and Common Law, (Cambridge: Cambridge University Press, 1952) p. 4. Merryman explains that the process of case law gradually defined certain legal principles; in turn these legal principles constituted the substratum for the codification process, which took place at a later stage. (See in general, J. Merryman, The Civil Law Tradition: an introduction to the Legal Systems of Western Europe and Latin America, (Stanford: Stanford University Press, 1969).

solution they provide to unforeseen problems. In this way, conventions become solutions to the recurrent problems that individuals face; eventually, these solutions can generate customary rights. It is important to realise why orders imposed "from the top" by a central authority somehow erodes these consolidated customary rights and conflicts with better coordination within the social system.

The informational role of social rules is best achieved if they are flexible enough to conform to markets' open-endedness, thereby adjusting to unforeseen contingencies, while providing a framework of stable principles whose steady evolution they can follow. Hence, these conventions should be simultaneously stable and flexible to adapt to new circumstances. In this sense, "stability" provides individuals with the predictability they need to pursue their goals, while "flexibility" becomes decisive in permitting market participants to adjust their conduct to unforeseen problems and envisage new solutions. In sum, the rule of law under this perspective fulfils a dual informational role: it reduces entrepreneurs' sheer uncertainty to tolerable levels, while it gives them the means to discover new solutions through a flexible framework.[359]

Let us look at these two questions more in detail.

i) <u>The provision of predictable boundaries against sheer uncertainty</u>.

Social interaction generates a spontaneous trial-and-error process which individuals undertake in order to select the patterns of behaviour that provide a more efficient solution for a recurrent *class* problem. Whenever individuals face a *class* problem they

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359 In this regard, North observes: "Different institutional rules will produce different incentives for knowledge acquisition, for 'learning-by-doing' and for the selection of those required verifications. Rules will determine not only the types of viable and profitable economic activity (i.e. productive activities *vs.* redistributive activities), they will also provide for the efficient adaptation of business internal structure and organizations through laws regulating entry into the structure of government and the flexibility of those organizations. In particular, rules encouraging development of tacit knowledge, and therefore, of creative entrepreneurial talent will be important." (J. Stiglitz et al., <u>El Papel Económico del Estado</u>, Instituto de Estudios Fiscales, (Madrid: Ministerio de Economía y Hacienda, 1993), p. 121.) North emphasises the two conditions that these institutional rules should meet, namely, providing sufficient stability for businesses in their dealings with the government, and enabling a sufficient degree of flexibility to adapt to unforeseen changes.

devise a hypothetical solution and test their hypothesis. The results may prove the hypothesis to be false or the hypothesis may continue to be operative until it is eventually proven to be false.[360]

As a result, individuals learn to cope with problems arising from their interaction. In a time-evolving framework, decisions are speculative and experimental, but experiment results in accrued learning in which individuals, in the process of carrying out their plans, develop new strategies or routines that enable them to cope with the practical problems they face.[361] Institutions emerge whenever the problem-solver finds a solution to a recurrent "class" problem; in this case, the solution becomes the routine solving of a problem repeatedly arising over time. If the problem is not recurrent, the new learning is stored away in case a similar situation occurs in the future. In an evolving and changing world where the future is unknown, people can confine their expectations to certain parameters which allow them to make plans in line with their goals. The fact that the "class" problem is identified allows individuals to devise stable conventions to solve it, which reinforces their expectations.

However, these solutions are ephemeral. As new unique events arise, creating new problems, individuals must reconsider their tentative solutions to prevent their expectations from being undermined; if problems are repeated, they develop new routines, which reformulate the effective institutional setting in which they place their expectations. In this process, however, successive solutions steadily push uncertainty away, and even though new ignorance emerges (due to the emergence of unforeseen unique events), progress is nevertheless made.

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360 Vaughn, Institutions..., pp. 10-12.

361 Obviously, the process of developing routines is not similar to the "maximising behaviour" concept put forward by the neo-classical school. As Vaughn argues, the differences are crucial: maximising models imply that the decision is instantaneous (no time to deliberate); that it is unproblematic (perfect knowledge); and that the choice is always correct (the objective is always achieved: Why then, experiment?). By contrast, the "institutional" problem solver takes time to sort out options through a mental process of trial and error: he may find that his initial solution is unsatisfactory and therefore requires more experimentation. Further, the source of change does not need be external to his own mental state. The institutional problem solver may find new problems by developing mental conjectures about an old pattern of ideas, or the new configuration or events or materials. (Vaughn, Institutions..., p. 10)

The closer expectations are to the routines that solve class problems, the more "efficient" these are. Under these circumstances, routines convey meaningful information to the actors, thus considerably reducing the uncertainty of their future mutual behaviour. The likelihood of making forecasting errors will diminish.

In terms of costs, routines eliminate present day costs arising from uncertainty about the future. Once firms know their costs (for which they must have clear objectives), it is only a matter of deciding whether the course of action chosen is correct. As Wiseman argued: "Once we admit that the future is unknown, analysis of the behaviour of producers in terms of adaptation to *known* future conditions becomes irrelevant".362 The picture is open-ended; therefore, one cannot devise a precise future state.

This is why parties develop legitimate expectations in such a changing process (and will respect the rule thus created), focused on the fact that everyone will stick to these routines, *as long as the circumstances underpinning them remain unchanged*. In this exercise individuals may, of course, differ in their interpretation of which circumstances change, and which remain the same. The role of judges in common law systems, who ascertain the material facts that make up the *ratio decidendi* of a case, is essentially to attempt to identify the substance of such mutual expectations in order to determine which interpretation should prevail.363 As Choi contends: "The very development of conventions has the effect of stabilising the individuals' expectations about each other. As they are the results of individual's search for order and regularities, the majority of people in society can be seen as *conforming* to conventions. Those who conform to conventions,

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362 Wiseman, Uncertainty..., p. 233.

363 It is in this context that the notions of "good faith", "bonus pater familiae", and "negligence", to mention only a few, are interpreted under particular cases. All these concepts possess an "inner" content, which cannot be differentiated from the particular circumstances in which they apply. But, in a changing world, such limits would steadily change in a process where rules capable of providing more information to market participants would replace less capable ones, and endure over time. See G. Williams, Learning the Law, (London: Stevens and Sons, 1982, pp. 67-96. Also, M. A. Eisenberg, The Nature of the Common Law, (Cambridge: Harvard University Press, 1988.)

in turn, have the expectation that others will also conform, in that others' conformity is the necessary (and often sufficient) part of the viability of the conformists' action. Often, the expectations of others' conformity assumes the character of customary rights".[364]

This explains why people enter into transactions knowing that to achieve their future goals they may have to co-operate and bind themselves through contractual and legal rules. They ensure the inescapable commitment of the other trading entrepreneurs, thus enhancing expectations of their conduct. As Macneil contends, contracts are "the projection of exchange into the future".[365] These instruments provide entrepreneurs with a legal certainty, on which they can ground their expectations about the use of resources in the future. Therefore, the instruments allow them to reduce uncertainty under a certain number of otherwise unknown future conditions. In turn, it is the entrepreneurs' willingness to avoid the uncertainty of the future that provides their commitments with coercive power. The problem then is to determine how precisely individuals frame their legal relationships in a dynamic evolving framework.

Let us now turn to this second question.

ii) The discovery of unforeseen *new* knowledge.

Conventions arising from positive expectations do not only limit "sheer" uncertainty by enabling stability to exist within the system, they also increase the possibility that entrepreneurs will discover new knowledge. Conventions may be useful for stabilising expectations over a wide range of possible future courses of action, but not over all of them because new circumstances could render current routines obsolete. Choi notices the tension between stability and flexibility in the following terms: "If conventions are enabling by their stability, they are also delimiting by their inflexibility".[366]

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364 Choi, On Neglected...

365 Macneil, The New Social Contract..., pp. 4-10.

366 Choi, On Neglected..., p. 12.

These routines may only be coercive *inter alia*, that is, between those who commit themselves to the belief that by sticking with them the problem will be solved. Routines may be efficient in dealing *inter alia* with a particular "class" problem which would otherwise increase the uncertainty of entrepreneurs. This keeps the expectations of both parties within certain bounds. Beyond those limits, however, firms may find opportunities to discover new information through competition to fill emerging gaps of information which have not been addressed in the prevalent routines. These gaps are the result of informational changes introduced into the system; they induce entrepreneurs to devise and implement new ways of solving any problems created. Competition enables entrepreneurs to "co-ordinate" themselves within respect to profit opportunities, thus revealing gaps of uncoordinated information. Those gaps represent instances where unsatisfied customers are awaiting improvements in the quality or price of the products traded. Successful solutions create new knowledge, hence new routines, which are imitated by other entrepreneurs. In this way, through the process of building new routines, knowledge is disseminated throughout the system for the benefit of all.[367]

It may be that the old routine prevented entrepreneurs from either discovering new opportunities or reaping the profits from discoveries already made. The gap between actual and potential (i.e. neglected or impossible) opportunities widens over time; as the gap becomes wider it is easier to see it.[368] Over time, this process will encourage entrepreneurs to deviate from the conventional rule, and outdo others in finding a new routine first (i.e., solution) for successfully addressing the problem created by the informational change. Of course, entrepreneurs departing from the conventional solution are frequently regarded as deviants by the rest. Any policy intended to enhance the entrepreneur's discovery process must ensure that individuals are not forestalled in their

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367 We have already seen that due to the endogenous nature of changes in the system under the institutional paradigm, a new solution to a problem of knowledge inevitably creates new problems. (See section 1 b above in this chapter) Choi argues that the "non-conformist tendency is ever present" due to the different perceptions people hold about similar events and facts (Choi, On Neglected..., p. 12.)

368 Choi, On Neglected..., pp. 13-14. In general, see Y. B. Choi, Paradigms and Conventions: Uncertainty, Decision Making and Entrepreneurship, (Ann Arbor: The University of Michigan Press, 1993.)

endeavours to narrow the gap, should they realise its existence. This is why "free competition," understood as freedom of entry into the market, is a concept that bears little resemblance to "perfect competition" which is related to permanence in the market at any cost, even if that frustrates plan co-ordination.

Similarly, in a dynamic process, *rivalry to discover knowledge gaps cannot be isolated from the conventions that give rise to them.* New discoveries accruing from entrepreneurial rivalry where each anticipates other's behaviour, are the consequence of gaps left because no convention can possibly forecast all possible contingencies that may arise in the future.

To sum up, competition and co-operation amongst entrepreneurs are inextricably linked. To express the complexity of this phenomenon, it is useful to detach the term "competition" from its colloquial use, i.e., that it is exclusively about "rivalry" between entrepreneurs involved in similar activities, and to see it in conjunction with the co-operation that firms engage in to further their discoveries of valuable information.[369] Adaptable institutions emerging out of this interaction between competition and co-operation play a key role in facilitating exchanges that take place between individuals.

Perhaps this is most clearly seen in the realm of market functioning. Here, the role of business organisations is essential through a wide array of different arrangements which entrepreneurs implement in order to achieve their particular goals.

369 Using a neologism, Nabeluff and Brandenburger refer to this phenomenon as "co-opetition". See B. Nabeluff and A. Brandenburger, Co-opetition, (New York: Currency Books, Doubleday, 1996). In this work, the authors indicate: "Business entails co-operation when baking a cake and competition when it will be sliced. In other words, business entails both things: war and peace (...). The goal is to obtain some benefit. Sometimes it is achieved at the expense of others, sometimes it is not (...). In business, someone's success does not demand that others fail, since there may be multiple winners". (pp. 4,5)

2.- THE ROLE OF ORGANISATIONS IN ECONOMIC OPEN-ENDED SYSTEMS.

Organisations are clearly essential for making it possible for entrepreneurs to undertake activities that they cannot pursue in isolation.370 However, conventional theory does not acknowledge this fact. For a long time, the theory of the firm could not render a plausible explanation of the firm, which remained confined to a "black box".371 Industrial organisation approached markets and firms as opposing entities, regarding the latter with suspicion for bringing about inefficiencies to the social body. However, in the real world there is no such division between firms and markets. Instead, there is a continuum passing from transactions, such as those organised in the commodity market where co-operation is negligible, through intermediate areas where there are linkages based on goodwill, to complex and interlocking clusters, groups and alliances, which represent fully developed co-operation. How do these organisational forms emerge and why? Mainstream theories

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370 Organisations are here taken as encompassing any form of inter-firm co-operation among entrepreneurs, regardless of whether they are formalised into explicit arrangements or not. They include a vast array of corporate structures, business practices and patterns of regular behaviour.

371 Neo-classical theory was never interested itself in the nature of the firm, which was regarded as a sort of "anomaly" in the market system, whose emergence did not fit into its basic premises about the interaction between the forces of supply and demand. It was Ronald Coase who made the first important attempt to clarify its emergence within the market system. In *The Nature of the Firm*, Coase described the firm as an institution that emerged whenever using the market price system was more expensive than planning. In such cases, there were costs of doing business ("transaction costs") which forced entrepreneurs to choose hierarchy and planning rather than resorting to market exchanges. (R. H. Coase, "The Nature of the Firm", 4 Economica n.s. [Nov. 1937], 386-405.) Coase's work persuaded economists to regard transaction costs as a determinant factor in the emergence of firms; however, he himself still contended in the 1970's that his paper had often been quoted, yet little understood. (See, Coase. "Institutional Structure of Production", p. 5.) In fact, the neo-classical theory of the firm does not examine its nature and therefore leaves many aspects in the dark. *Neo-classical* theories do not explain how inter-firm division of labour comes about. Instead, they assume "given production functions" which represent *the maximum output obtainable from different input combinations*. This representation of productive possibilities *neglects the roles of organization, knowledge, experience and skills*. Yet, production has to be undertaken by human organizations embodying appropriate experience and skill. Firms carry out an indefinitely large number of activities related to the discovery and estimation of future wants, research, development and design, marketing and transformation of physical goods. These activities require the appropriate knowledge, experience and skills: command of a particular technology, skill in marketing or reputation in a particular market. (Richardson, "The Organization..."). These are essential to understand why firms sometimes co-operate and why they sometimes act as rivals. It is also important in understanding why they develop new products, innovate and make improvements, which is our goal.

do not acknowledge this problem seriously, thus hindering a fuller understanding of the causes for the growth of firms.[372]

Antitrust analysis suffers from this inability to understand the nature of firms. Thus it condemns several forms of market arrangements to being branded as "anticompetitive" restrictions which deserve surveillance. However, under an alternative approach which emphasises the evolution of markets, "restrictive" contractual arrangements and corporate arrangements that managers normally adopt in their activities reveal many more efficiencies than antitrust scholars are ready to concede. This is not however clearly realised unless we abandon the heuristic equilibrium models of neo-classical vintage. This is what we have emphasised in the previous section, and we will now apply it to the analysis of market functioning.

Thus, in this section we will explore how, under an alternative institutional viewpoint, market arrangements currently prohibited or restricted by antitrust statutes appear to be *the very expression* of different degrees of co-ordination, the efficiency of which becomes evident in the long-run. This could provide a good measure from which to consider the legality of these contracts and business undertakings. This section will show why these conducts should be preserved, provided they reinforce entrepreneurs' expectations within the market.

2.1.- The co-ordination problem of entrepreneurs in decentralised market settings: competitive and complementary investments.

The transmission of information is decisive in the functioning of decentralised market systems, because only in this way can individuals co-ordinate their activities successfully. In market economies, individuals are independent of central direction, yet

372 More recent studies in the field of industrial organisation regard the firm as a structure created for the solution of the incentive problem created by the agent-principal relationship. However, these improvements of the conventional view still present a faulty explanatory basis for appraising the subjective nature of the knowledge held by those interacting within firms and market organisations. See N. Foss, On the relations between Evolutionary and Contractual Theories of the Firm, DRUID Working Paper No. 97-4, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1997.

their activities are interrelated by a network of organisations which allow transmission to occur throughout the system.373

In order to make information available, firms engage into a variety of "restrictive" conventions, either in contractual form or simply as self-imposed routines. These restrictions provide mutual boundaries aimed at providing some chance of predicting the conduct of other businesses with success. These boundaries also leave open the possibility for businesses to reconsider their respective positions should new problems arise. In this way, parties give *tentative* assurances about their commitments.

Any forecast of future levels of demand is inevitably imprecise, but that does not relieve firms from committing themselves to investments today to meet future demand. Because of sheer uncertainty, firms must develop devices to reduce their uncertainty to a level where they will have sufficient confidence to make investments. This is important for firms because once an investment is made, it is unlikely that the investing firm can withdraw without suffering losses. Hence, managers must be certain that other firms are committed to what they believe are their commitments; in other words, that their expectations will not be frustrated. As Schumpeter contends: "Enterprise would in most cases be impossible if it were not known from the outset that exceptionally favorable situations are likely to arise which if exploited by price, quality and quantity manipulation will produce profits adequate to tide over exceptionally unfavorable situations provided these are similarly managed."374 Organisations spring either in the form of self-imposed routines or through contractual commitments ensuring that vital information is generated and passed on to all those involved thus creating such "exceptionally favourable situations".

373 Richardson clearly states this point, which is neglected by neo-classical "omniscient" models: "(...) what commonly fails to be recognized, (...) is that the possibility of forming reliable expectations is not independent of the particular market conditions which define the model employed. [On the contrary] it is the availability to entrepreneurs of this information (...) which is a function of the nature of the particular form of economic organisation or system within which they are presumed to operate. [Therefore] the extent to which an entrepreneur can obtain market information can be shown to depend on the nature of the prevailing economic organization". Richardson, Information ..., pp. 29,30.

374 Schumpeter, pp. 89-90.

Firms must know that such favourable conditions will be "there" when the time comes, otherwise, they will refrain from investing. Anticipated knowledge in the form of reliable expectations is essential for establishing the present level of investments that firms are willing to make today to meet future aggregate demand. But such knowledge does not relate to "objective" future circumstances which, after all, are pure speculation; it relates to the subjective perception of the investor that other market participants will have a certain set of beliefs about what the future will bring.

The volume of investments will ultimately depend not so much on increases or reductions in future aggregate demand (a fact that only a prophet could predict) but on the volume of both competitive and complementary investments that each firm *hopes others will commit today*. Entrepreneurs don't know for sure what these volumes are. Even if they communicated their intentions to the rest, others would have to trust them and align their conduct accordingly. However, trust is not built on mere communication, for entrepreneurs may be tempted to cheat to obtain an advantage.375 Something *else* is necessary.

Entrepreneurs speculate about the levels of investment other firms will make in the event of a foreseen increase or reduction in future aggregate demand. For this reason, they must identify the minimum amount of information required, and the different conditions which permit access to it.

The devices which entrepreneurs employ to gather information may take multiple forms, but what they all have in common is that they consolidate the expectations of market participants by reducing their uncertainty to tolerable levels. Notice that legal formalities represent a mere additional consideration in the process of building business trust. Explicit arrangements through which price information is made available to

375 This is the classic Prisoner's Dilemma situation where some parties seek to gain advantages by cheating the rest; these situations call for intervention to discipline members of the group. (See A. Dixit and B. J. Nabeluff, Thinking Strategically, W.W. Norton & Company, New York, 1991.) The application of game theory models in the law is explored in D. Baird, R. Gertner and R. Picker, Game Theory and the Law, (Cambridge: Harvard Unversity Press, 1994.)

entrepreneurs may take several forms which are either structured into formal legal arrangements or not. Thus, the form adopted by organisations does not, in principle, rely upon the legal form chosen by entrepreneurs. Rather, it depends on the position that each market actor holds *vis-à-vis* the rest (both competitors and customers). The goal is to adjust *ex-ante* to the behaviour of other firms in the system in order to minimise possible losses resulting from misleading interpretations of the content of the commitments negotiated.

Such adjustment can take alternative forms, depending on the kind of relationship that the entrepreneur concerned has with the others. It is possible to distinguish between the adjustment that rival firms seek to make with respect to their share in an uncertain future level of aggregate demand, and the adjustment that firms seek with their customers and suppliers to ensure a minimum level of commitment in response to such an uncertain aggregate demand. In this respect, firms may be placed either in a competitive or a complementary relationship.376

Firstly, firms may be put into a *competitive relationship*. In this case, consumers regard the commodities they offer as similar products, or more technically, effective substitutes; in this case, the profitability of the investments of one entrepreneur will be reduced by the investment plans that others implement. Therefore, he will be induced to enter into more or less formal communication with his competitors, to avoid making mistakes on the amount of resources he devotes to production. Underestimating others' capacity or willingness to invest may result in excessive future output and waste for all. At the same time entrepreneurs are guided by the opportunities in sight to attempt to attain the highest possible level of investments in order to maximise profits. Each entrepreneur will bear an internal tension between following the rule or routine laid down by all, which would give everyone (including him) more certainty, and breaking the rule if that should ensure him a better chance of maximising profits.377 Therefore, these

376 Richardson, Information and Investment, pp. 49-87.

377 J. Kaisla, Market Process and the Firm: Some Indications of Rule-Following and Entrepreneurship under Genuine Uncertainty, DRUID Working Paper No. 98-17, Department of Industrial Economics and Strategy, Copenhagen Business School, Copenhagen, 1998.

agreements and routines do not ensure that entrepreneurs will not violate them (or expect others to violate them) should the particular circumstances dictate it.

Secondly, firms may be placed in a "vertical" or *complementary relationship*. Here, the profitability of one investment is increased by making another: for example, where the increased availability of one product increases the demand for another, or where the output of one firm provides an input for the manufacture of another. Like firms making competitive investments, those making complementary ones must have information available in order to be encouraged to invest. In other words, the entrepreneur has to determine the minimum amount of information required, and the different conditions that would permit access to it.

In this case, investors need to be sure that other entrepreneurs will commit a minimum volume of complementary investment. Here, the entrepreneur willing to satisfy a predicted demand for the production of widgets by seizing a profit opportunity may require complementary firms to make a minimum investment for the production of some required inputs. However, firms in one industry may not be prepared to expand without the assurance that others will follow suit; and even where no explicit assurance is available, there may be a strong presumption that the necessary investment will take place. In the ongoing process of informational change, entrepreneurs must have access to the information necessary to adjust production to market changes sucessfully, so as to particularise a general profit opportunity into profit opportunities for each of them. These conditions rest on the premise that everybody else will behave as expected.

In addition, firms may be competitors in respect to one product, and complement each other in respect to another. Firms that were initially competitors in one market may develop some differentiation, making their respective products seem less like substitutes in the eyes of consumers, and eventually not as interchangeable.

The distinction between competitive or similar investments and complementary ones is essential for identifying the sort and variety of restrictive arrangements that firms seek in order to reduce their uncertainty about future market conditions, and in particular.

the future volume of investments that other firms may make. The next section will deal with the variety of these arrangements more extensively.

2.2.- Organisational variety and the co-ordination of production.

Entrepreneurs get the information necessary to invest on the basis of approximations and "educated guesses" based on the conduct of those they interact with (competitors and clients) and the kind of productive activity that they intend to undertake. There are several signals they look for in order to form reliable expectations about the commitments of firms making complementary and competitive investments.

For example, they may rely upon the expectation that the status quo of their trading relations will remain unaltered. They may be persuaded that competitors will not make a move unless circumstances change; or that such moves, if they should happen, will follow a pattern. (For example, seeking to enhance production to retain the same market share). Also, they may rely upon an appraisal of the feasibility of competitors seizing such an opportunity. If they know that competitors will be unable to seize the opportunity for economic purposes, it will be as if they had never known. Finally, they may rely upon the level of perceived loyalty of their consumers, or of their competitors. To adjust their offers to future demand, entrepreneurs must protect their markets from any undercutting by potential competitors. Consumer loyalty is essential in this calculation. For this purpose, they may develop a differentiated product, based on the reputation or particular attributes of the goods they sell, or on lower transport costs, or on the location of the goods or services they provide. They may also develop a particular "goodwill" which differentiates the quality of the service they provide, as for example, treating loyal customers better, or offering rapid delivery; servicing facilities; policies of special customer treatment, etc. Another strategy may be to maintain prices irrespective of changes in demand. If prices are flexible, it is not possible to ascertain the magnitude of the demand changes for which producers should plan. In connection to this, waiting lists, advance orders and other similar phenomena arise as a result of price rigidity, but do not necessarily entail inefficiencies; they may well be indicative of future sales.

At times, however, entrepreneurs may have to enter into a variety of more formal restraints of differing strengths and duration, which would restrict their freedom of action. These arrangements may take two forms: Firstly, entrepreneurs may endeavour to secure their individual investments by entering into agreements with their competitors. These arrangements may take the form of price alignment; market sharing agreements; or tacit understandings to avoid ruinous competition in a particular line or product.

Secondly, producers may increase the security of their individual investments by developing special links with their suppliers or clients. For example, they may enter into exclusive dealings to ensure custom for the entire future period. Where raw materials are involved, it is difficult to develop goodwill or product differentiation. In these cases, it may be better to ensure trade by contracting a quantity of the commodity for sale at a future date and at a fixed price.

In this regard, Richardson classifies organisations on different levels as follows: firstly, a trading relationship between two or more parties, which is stable enough to make demand expectations more reliable, and thereby facilitates production planning. This is the simplest form of inter-firm co-operation. In this case, the relationship may acquire its stability through goodwill or more formal arrangements such as long-term contracts or shareholding. The selection of any of these arrangements is a matter of qualitative rather than quantitative co-ordination. The habit of working with models that assume a fixed list of goods may be responsible for the neglect of consideration of qualitative co-ordination in terms of the balancing of quantities of inputs-outputs.

Secondly, one firm may subcontract another by outsourcing. This modality is becoming quite popular for co-operation between firms located in different countries. Subcontracting does not in itself imply much co-operation; and may be the result of competitive bidding. Stability arises from the fact that subcontractors assume the risks inherent to their narrow specialisation in skills and equipment; and from the fact that it permits continued co-operation between those concerned with the development of specifications, processes and designs.

Thirdly, co-operation between firms relying on each other for manufacture or marketing. These relationships may entail complex patterns of co-ordinated activity, ranging from quantities demanded (promoting quantitative adjustment of supply to demand), to qualitative standards involving processes or products.

Finally, co-operative arrangements specifically contrived to pool or transfer technology. These agreements are commonly based on the licensing or pooling of patents but they provide for the provision or exchange of know-how through the transfer of know-how, personnel, drawings and tools. They are normally associated with price agreements, market sharing and the like.[378]

To sum up, organisations adopt their particular shape as a result of conditions imposed on them by the market in which entrepreneurs operate. They do not necessarily stem from the "intentions" of entrepreneurs to engage in unfair restrictive trade practices.

Rather, the choice of these arrangements depends on the level of information they are supposed to convey, which is contingent with the perception that each entrepreneur holds of those others whom he deals (trusts) and with the complexity of the productive processes involved in the particular activity. In other words, organisational choice is constrained by the length of the relationship (as new circumstances emerge) and complexity of knowledge (as knowledge of other realities encourages the revision of initial plans). Information costs in this subjective sense are therefore essential in shaping the particular organisation sought by entrepreneurs. The optimum size of a firm will not be determined not so much by the scale of economies associated with any particular operation, but by the number of complementary operations requiring planned co-ordination. The length of time required for productive purposes and the complexity of production are ultimately responsible for the size and shape of inter-firm co-operation.

378 Richardson, "The Organization...,"

a) The role of mutual trust in shaping organisations dealing with the complexity of production in evolving settings.

An effective level of trust between entrepreneurs is essential in encouraging them to make complementary investments. The intensity of commitment which will reveal how willing they are to integrate their activities for the common interest, will depend to a large extent on the length of time that both parties envisage their relationship to last.

In principle, mutual trust depends on the length of time within which both parties are certain about the commitment of the other. As we have indicated above, contractual formality is contingent with the level of certainty and the length of time that parties can foresee it lasting at the present time.

In this context, the form of organisation chosen by entrepreneurs will depend on the level of opportunity to frame the conduct of each participant, without losing the flexibility needed to adapt to unforeseen changes. The longer the period envisaged, the more flexible the investment programme. But the longer the contract extends into the future, the more likely it is that uncertainty is increased due to unforeseen events. This is also likely to restrain the entrepreneur from modifying his plans to meet unexpected developments. The point will be reached where the greater predictability yielded by contracts does not justify the loss of flexibility involved; for this reason, co-ordination through market interaction can never be *perfect* and firms will inevitably engage in forms of vertical integration. The unavoidable imperfection of economic information will therefore limit the willingness of entrepreneurs to enter into contractual arrangements that could increase the supply of market information.

Entrepreneurs cannot rely on the wording of a contract, and must therefore rely on an analysis of past behaviour, which involves knowledge that cannot be quantified. The conditions for supply (quality, quantity, specifications, etc.) cannot be fully specified, and therefore cannot replace goodwill and reputation. This information cannot be completely expressed though contractual arrangements.

Thus, where parties are unwilling to accept obligations with respect to their future behaviour, co-operation cannot take place. In these cases market transactions replace co-operation. Here, there is no continuing association.

It may be difficult to arrange a prospective return through long-term contracts in proportion to the risks that parties are assuming if such risks, relating to class problems, are unknown. For example, one party may be required to make heavy investments in exchange for a return several years ahead. In this regard, long-term contracts are only one way to ensure control of the firm responsible for complementary investment. There may be other ways of ensuring compliance and further control, such as establishing special price conditions.[379] Another solution, when the risks are high (say, due to faulty contractual enforcement procedures), is to set up a more intimate form of co-operation than a contract. The two companies might form a subsidiary in which they both possess equity interest, or might decide to merge.[380] With regard to this, Fukuyama argues that firms may resort to alternative "unofficial" alliances, such as family bonds, to increase the level of trust that cannot be gained through official channels in "high trust" societies.[381]

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379 Klein and Leffler hold that there could be risks of non-performance where the costs of withdrawing from a transaction are low to one party and high to the other. One solution these authors propose is to increase contractual prices. A necessary and sufficient condition for performance is the existence of prices sufficiently above salvageable production costs so that the nonperforming firm loses a discounted stream of rents on future sales which is greater than the wealth increase from non-performance. Another solution, when determining the risks involved in the long-run proves difficult, is to merge both firms: in this way compliance is ensured through common stock and the expectations of the firms involved will not be diminished. (See B. Klein and K. Murphy. "Vertical Restraints as Contract Enforcement Mechanisms". 31 Journal of Law and Economics [1988]: 265-298. Also, B. Klein and K. Leffler, "The Role of Market forces in Assuring Contractual Performance". 89 Journal of Political Economics [1981]: 615- 641).

380 Obviously, under this corporate form parties would still be related under a contractual bond, but such a link would be more complex in nature, and regulated under more severe conditions than a simple contract.

381 F. Fukuyama, Trust: The Social Virtues and the Creation of Prosperity, (London: Hamish Hamilton, 1995.

For this reason, the longer the relationship is between investors, the more important the links to eliminate uncertainty are because the parties will have more trouble identifying possible changes.[382]

Naturally, an effective level of trust is not determined by a single factor. Other factors come into play which influence the level of reliability that entrepreneurs can reasonably expect from each other. Amongst these factors, the number of alternative suppliers or customers is paramount, as this will give participants a measure of actual or potential contract alternatives. Entrepreneurs acquire information about other market participants from several sources. In the first place, they look at their numbers. If, for example, entrepreneurs have fewer clients, their need for evidence of commitments is likely to be stronger; therefore, they tend to integrate vertically in these cases. By contrast, with larger groups, firms tend to rely on the aggregate supply of complementary investment to influence their investment decisions. If an entrepreneur fails to make a deal with one participant, he knows he is likely to find another participant to deal with. For this reason, the extent of co-ordination of complementary activities depends on the degree of development of the country within which they are undertaken. In a more advanced country, with a large manufacturing sector, the output of one industry is likely to have a large and varied number of outlets so that there is no need for an acute complementarity between the investment decisions of any particular units. In less developed countries, with fewer firms, any increase in output would have to be absorbed by a small number of complementary firms. Complementarity would be strong, and profitable investment by one producer might depending on the expansion of the others.

382 Klein and Murphy argue that vertical restraints are means which ensure compliance from dealers when written contracts are not economically feasible because they would have to cover every possible contingency. Manufacturers use vertical restraints to reduce the short-run gain (by limiting non-performing dealers' ability to expand output) and to increase the long-run gain of performing dealers (by creating a quasi-rent stream). To induce a desired retailer behaviour when it is not feasible for a manufacturer to write explicit, court-enforceable contracts with retailers for the supply of particular services, the only mechanism is to increase the direct return which retailers receive from consumers when those services are supplied. Resale Price Maintainance increases this return by increasing the retail margin, thus creating an incentive for individual retailers to engage in non-price competition and supply the desired services. Exclusive territories increase the direct return by eliminating nearby retailers (Klein and Murphy, "Vertical Restraints...", pp. 265-298).

b) The variety of organisational forms as a consequence of production processes.

A second factor determining an entrepreneur's choice in favour of a given organisational arrangement is the complexity of productive activities which developed through joint action.

Firms perform a myriad of productive activities, including manufacturing, sales and services, consumer support, research and development, and so forth. All these activities require "capabilities", which may be undertaken by a single firm or by several firms linked together with contractual bonds.[383] In the face of uncertainty, firms create "reserves" and develop "capabilities" of skills and knowledge, which enable them to cope under any unexpected circumstances. Under this perspective, and Adam Smith's ideas on the division of labour, firms tend to specialise in the activities for which their capabilities offer comparative advantage.

The nature of productive activities exploited by entrepreneurs will determine whether certain capabilities held by a single firm will suffice for this purpose. In other cases, it may be necessary to contract other firms which possess different capabilities in order to exploit the activity successfully. Thus, firms develop around closely complementary capabilities, and inter-firm outsourcing subsequently results if the activities involved are "dissimilar". Entrepreneurs enter into co-operative relations to gain access to upstream or downstream activities because the activities concerned are complementary. Indeed, in these cases it would not be convenient for a firm to undertake "dissimilar" activities because that would bring diseconomies of scope and/or increased informational costs. It is preferable to develop co-operation through inter-firm arrangements such as long-term contracts, joint ventures, licensing agreements, and so on.

383 The capabilities theory contrasts with the contractual explanation followed by neo-classical authors. (N. Foss, Capabilities and the Theory of the Firm, Danish Research Unit for Industrial Dynamics, Working Paper No. 96-8, Copenhagen Business School, Copenhagen, 1996.)

Also, capabilities evolve on an ongoing basis, thus changing the landscape of co-operation agreements, firms and markets.

Initially, firms comprise undifferentiated capabilities, but entrepreneurial discovery eventually leads firms to a variety of markets and product lines.[384] "Imagination, rather than information in any ordinary sense, is what entrepreneurs require in order to discover new ways of combining resources so as to meet consumers' desires; production functions exist unknown to entrepreneurs only in the sense that musical tunes await discovery: in either case originality, rather than the possession of 'information', as considered exclusively hitherto, is what is required for successful new combinations to be produced".[385] Therefore, the variety of production lines is inextricably linked to the discovery process that shapes competition: "the scope of entrepreneurial, or competitive activity, is therefore much greater in reality than in the so-called purely competitive model".[386]

The activities of firms trading in apparently different activities may be more similar than they appear. At first sight, a firm may seem to be acquiring another which is engaged in different activities, but the activity could be interpreted as similar if the firm is bought to restore efficient management before reselling. Management would be the particular capability in this case.

Therefore, firms' capabilities determine the different directions in which companies grow, depending on whether they (the capabilities) expand and alter. However, random factors also have an influence: in these cases, a firm's motivation for taking up an activity is not determined by the prior possession of an appropriate capability, but by cheap acquisition.

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384 C. Menger explains how firms initially undertaking activities in a given sector expand into other sectors by concentrating on what they are better able to perform. (C. Menger, The Principles of Monopoly Trading in "Principles of Economics" (New York: New York University Press, 1981).

385 Richardson, Information ..., p. 105.

386 Id.

New products frequently emerge from the combination of different capabilities and skills. Inter-firm co-operation enables these capabilities to combine and create new products and services. Hence, complementary activities become the source of co-operation among firms; the less complementary they are, the more likely firms are to compete for a bigger share of the undifferentiated "aggregate" demand. In this case, price competition will often be the prime element of differentiation between them, but the scope for competition is very limited, as it will be constrained by price reductions. Assuming that producers choose to make the same commodity with similar production processes, competition between them is possible only as long as costs are reduced. Such reductions will consist of minor improvements to the production process. However, if producers devise new "production functions", combining resources in different ways to make the same or different commodities, the field for active competitive warfare is greatly enlarged and there is wider scope for innovation.

Conversely, the process of competition and exploiting comparative advantages may develop particular lines of products which could turn formerly similar activities into complementary ones. This process explains why former rivals may find it desirable to co-operate in developing new products, by mutually exploiting their respective complementary capabilities. It also explains why, during their initial stages, markets tend to consist of few firms, each holding a strong position. As time passes, more entrepreneurs become capable of seizing profit opportunities by imitating successful entrepreneurs. Consequently, markets become less and less concentrated as technologies spread out amongst producers.

This could happen in markets where competitive entry is assured. Regretfully, the focus of antitrust enforcement has been misdirected into other matters, as excessive emphasis has been placed on market power attained, particularly while the market is in the initial stages of its development. This is clearly evident in the special focus placed on price considerations as the expression of such "power".[387]

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387 Schumpeter criticised this exaggerated focus of economists on prices as variables of competition: "[As a result of the alternative institutional analysis] the first thing to go is the traditional conception of the *modus operandi* of competition. Economists are at long last emerging from the stage in which price competition was all they saw. As soon as quality competition and sales

To sum up, firms will tend to develop closely complementary activities themselves, and leave dissimilar activities to outsourcing. Also, they will leave those transactions in which they feel that there are sufficient alternative providers for markets, whereas they will attempt to integrate those areas in which they are required to hold higher levels of trust, due to the features of the transaction concerned. This happens, either because of the need for endurance of the expectations of transacting parties over time, or due to the features of the activities that they engage in.

In the light of these considerations, Richardson distinguishes three modes of co-ordination of complementary activities between firms. Firstly, entrepreneurs may seek coordination through "direction", where single control fits into a coherent plan and is undertaken by one organisation. Direction within a firm is possible where economies of scale exist, and where complementary activities are possible: the larger the organisation, the greater the number of capabilities with which it may to be endowed, and thus the greater the number of complementary activities subject to co-ordination through direction it is likely to undertake.

Secondly, entrepreneurs may coordinate their activities through "co-operation", where independent organisations agree to match their plans in advance. Co-operation arises where there is reason to believe that individual components (i.e. the interactive parties) of demand are more stable than aggregate demand considered "as a whole". In this case, the individual parties would seek to match their investment and output plans *ex-*

effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position. However, it is still competition within a rigid pattern of invariant conditions, methods of production and forms of industrial organization in particular, that practically monopolizes attention. But in capitalist reality as distinguished from its textbook picture, it is not that kind of competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control, for instance) competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and do much more important than it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly; the powerful level that in the long run expands output and brings down prices is in any case made of other stuff." (Schumpeter, pp. 84-85.)

ante. They have to match "closely complementary" activities, rather than undifferentiated "similar" aggregates. Co-ordination is undertaken either through close co-operation, by institutional arrangements, by limited shareholding, or by other forms of affiliation. Matching is not only quantitative in this case, but also qualitative. The personal element is decisive; thus, prices are to some extent irrelevant, in the sense that their stability does not tell anything in itself about the value attached by the parties to their underlying relationship.

Finally, the co-ordination of complementary activities can be done through market transactions. Here, the benefits arise indirectly from successive interactive decisions taken in response to changing profit opportunities. In this case, the estimates that firms infer from the conduct of other firms are not based on the individual conduct of particular firms, but on their actions when considered as a whole. In this case, the crucial element for reinforcing expectations is not based on the conduct of the firms concerned, but on their particular features or pattern of activities, which are diluted in the presumed aggregate output of all those firms considered to be working together. Firms will prefer to rely on these market outcomes, rather than seeking to co-operate with a particular firm. Therefore, co-ordination through markets occurs whenever there is reason to believe that aggregate demands are more stable than their component elements (i.e. the parties involved). Thus, parties rely on having enough customers to cover the potential cancelling out of random fluctuations in their separate demands.[388]

These considerations allow a clearer understanding of the position in which the entrepreneur is placed when deciding which arrangement he will engage in. Vertically integrated firms coordinate closely complementary activities, whereas horizontal alignment should be expected amongst entrepreneurs whose activities are competitive and where the products and services offered thus require some degree of homogenization. Let us take a look at this problem in more detail.

388 G. B. Richardson, The Organization of Industry, in "Firms, Organizations and Contracts", P. Buckley and J. Michie (eds.), (Oxford: Oxford University Press, [1972] 1996.

2.3.- An alternative normative appraisal of economic organisation and market competition: Does organising production restrict economic freedom?

In the light of the ideas outlined previously, one can conclude that mutual trust and productive complexity fix the limits of business conduct and organisational structure. Consequently, arguing that entrepreneurs impose these restrictions on others to achieve some monopolist purpose through market power seems out of focus. Indeed, the conventional explanation of *market power* (that is, the feasibility of imposing a monopolistic price on consumers or of engaging in exclusionary conduct against competitors) becomes dubious as soon as we realise how irrelevant it is in the view of competition as a process.

In such a process, the position held by a firm at any given point in time does not prevent other firms from operating freely. In other words, it does not give them any "dominance" or "power" in the market. The suspected monopolist may have the intention of gouging out additional profit due to his pre-eminent position in the market, but that intention is only produced by his expectation that the profit opportunity is there for him to reap. He may well be wrong. Indeed, the fact that information about these opportunities is subjective and the position of our entrepreneur is pervaded by sheer ignorance affects him too. As Kirzner states, "...no one knows, and no one can possibly know, in advance, what 'the' market price 'ought to be'. (...) once it is recognized that no one does or can know the 'correct' price, it becomes apparent that a price discriminator is simply 'feeling' his way, by grasping (or rather, by attempting to grasp) profit opportunities he believes available to him."[389] Therefore, the firms' incentives to compete in the market are not determined by how much market power incumbent firms exercise either on those firms attempting entry or on established firms.

Size and pre-eminence in the market are not important factors as soon as we consider the availability of capital markets to alert entrepreneurs. Of course, the

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389 Kirzner, The Goals of Antitrust: A Critique. Article prepared for Información Comercial Española, New York University, September, 1998, p. 18.

possession and ownership of productive resources gives economic power. But this power does not become an essential factor in forestalling the freedom of other entrepreneurs if competitive entry is ensured. To understand this issue properly, let us examine the nature and effect of freedom of entry in more detail.

a) Competitive entry as the determining factor of market competitiveness.

The crucial factor of market competitiveness is *competitive entry*, namely, the awareness that institutional rules are sufficiently *flexible* to give anyone interested a chance to challenge established industries should the occasion arise. Competitive entry will be a sure deterrent to any entrepreneur attempting to lower the quality or increase the prices of products or services sold.

Competitive entry ensures that any firm, regardless of size, or any entrepreneur, regardless of their ownership of productive factors, will be able to enter into the market, should incumbent firms decide to raise prices beyond normal levels. It disciplines those entrepreneurs who attempt to restrict investments in order to maintain a rate of profit which is permanently excessive. In this case, alert entrepreneurs erode the position of the incumbent firm by exploiting those gaps of information discovered.

Competitive entry requires that no incumbent firm holds privileges which exploit productive activity. These privileges arise mainly from government fiat, as well as from private arrangements bearing similar effects. For example, laws, regulations, decrees, and other legal instruments belong to the first group, whereas arrangements adopted by trade or business associations (e.g., the cartellization of an industry, which is not to be confused with collusion among competitors) belong to the second. Indeed, the virtual effect of these private arrangements is virtually to function as a statute would, since their effects extend over a whole industry.

These privileges prevent entrepreneurs from exercising their alertness in the discovery of *future* profit opportunities, through whatever arrangements they perceive to be necessary in order to seize these opportunities and co-ordinate the social system by eliminating gaps of (thus creating new) socially valuable information. Therefore, competitive entry has little to do with the *prior* ownership of resources. Inequality in resource ownership and in the power that such ownership provides is irrelevant to the ongoing process of discovering future profit opportunities. "It is superior entrepreneurial perceptiveness and prescience alone which is necessary and sufficient for the grasping of pure profit opportunities".390 Even those firms commanding large volumes of resources must depend on their entrepreneurial foresight to find ways of deploying those resources innovatively. Otherwise these resources will simply continue to be used conventionally, until shrewder and more innovative entrepreneurs bid them away from larger but less entrepreneurial firms.

It soon becomes apparent that market power is non-existent in a changing environment as long as competitive entry remains unblocked. In this case, the relevant problem is not how many firms interact within the market, thus enabling them command of productive resources, but whether those within it will be threatened by the entry of others, and whether those outside will be allowed to erode the position of incumbents.

Thanks to the flexibility of the institutional framework market, actors possess freedom *to compete*. Notice that "competition" in this sense has little connection with, and even contradicts, neo-classical perfect competition. Indeed, the meaningful question is not whether firms want to eliminate their capacity to compete, but whether they will be able to do so indefinitely, thus imposing an absolute and unwanted restriction on freedom. Antitrust policy does not always make this distinction clear, as it confuses the number of competitors with their ability to compete.391 It is clear that in the long run, absolute

390 Kirzner, The Goals ..., pp. 10-11.

391 Machlup explains the sources of this terminological confusion: "The confusion is understandable: where there are *many* sellers already, why should there not easily be *more* sellers when profits lure? In actual practice easy entry into a trade and large numbers in the trade go well together". However, "even if a large number of sellers and an augmentable number of sellers seem to be closely correlated, logically the two things are completely divorced from each other. And, it will be seen, [they are concepts] of very different nature; indeed, *they belong to different spheres of thought*" (Author's italics). Machlup, pp. 1-2. See also G. Stigler, Memoirs..., pp. 92-93.

restriction on freedom in flexible institutional frameworks is impossible, due to market selection and discipline imposed over conditions of competitive entry.

In a free market, new entrants will seek to imitate formerly established firms, therefore reducing their profits. For this reason, a firm can freely expand output without the threat of excess competitive supply, but will have no protection against the ultimate encroachment of more innovative rivals and no opportunity to maintain profits at a permanently abnormal level. If entry is free, some barriers would persist while others would disappear as new entrants erode the position of incumbent firms, thus rendering any artificial restrictions useless. Therefore, under competitive entry indefinite market foreclosure is impossible.

b) The long-term efficiencies of organisational arrangements.

The former considerations tell us that social rules should not condemn market organisations as potential sources of undue market foreclosure. Exclusion or limitations of rivalry in a market may be necessary to ensure that a profit opportunity will be discovered and exploited at all. It may seem ironic (but no less true) that the more information there is available about these opportunities, the less likely it is that anyone will seize it.

Successful co-ordination of investment plans to reap profits requires the existence of certain natural or contrived restraints on freedom to seize shares in the profit opportunity. Natural restraints differentiate products and markets, thus making it possible for some entrepreneurs to seize profit opportunities by displacing others. They are the result of differing natural conditions imposed on different traders which are the creation of the structural conditions of the market concerned.[392] By contrast, contrived restraints

392 Natural restraints comprise, for example, restraints on production such as economies of scale in production. It may not be profitable for a newcomer to penetrate an industry if the minimum efficient scale produces additional output sufficient to cause a large fall in price, despite its apparent high levels of profits or low efficiency levels. However, rather than viewing them as entry barriers in the conventional sense of preventing individuals from attaining what is, in any case, an unattainable Pareto ideal, economies of scale are regarded as inevitable limitations on the production possibilities given the state of current technology. In addition, there are also restraints limiting the ability of firms to increase their sales, rather than their output, such as the

are caused by the purposeful action of entrepreneurs, and are relevant for the purposes of our normative study. Therefore, it is important to examine their relationship with the creation of informational conditions appropriate to successful coordination adjustment. Do antitrust tools allow a better coordination among entrepreneurs, and thus create the institutional environment for improving social coordinative efficiency?

Let us examine how some contrived restraints acquire a benign outlook under a market process perspective.

i) Prohibition against collusion among competitors.

Collusion among competitors is outlawed because it appears in a conventional perspective to impose monopoly-price dominance over consumers. It eliminates inter-firm price competition. However, as long as freedom of entry is allowed, such an arrangement should not affect the competitiveness of the market concerned.

Attempting to raise the level of prices beyond competitive levels leads to an invitation to new competitors into the industry. Of course, collusion will limit or eliminate the fluctuation of prices among firms participating in the arrangement, but that should not undermine the capacity of third parties to decide their course of action. Antitrust legislation generally regards collusion as a particularly harmful sort of business arrangement. However, from an institutional economic viewpoint it does not matter whether price increases are undertaken unilaterally or collectively. As long as competitive entry is ensured, the existence of the gap between the price charged as a result of the collusion, and the price consumers are really willing to pay (other conditions being stable) will create a proft opportunity for third parties to seize.

"goodwill" or reputation of certain firms enabling the attachment of customers, which deserve a similar treatment. Moreover, location or transportation costs may also permit inefficiency or deliberate supply restriction. Similarly, the legal protection afforded to trademarks or brand names may create inevitable difficulties for other firms when placing their competing products in the market. Similarly, albeit to a lesser extent, product variety may dispense some protection, though not much, since the nature of consumer demand changes. Natural restrictions will seldom seriously impede competition. On the other hand, they do not need to make information available; thus they cannot guarantee to promote efficient adjustment.

Perhaps the conventional view against collusion is severe because its beneficial effects are not readily seen under the conventional appraisal of economic theory. The historical experience of the destructive economic effect of cartels encompassing whole industries (which should be distinguished from the naked price fixing condemned by antitrust policy) has played a persuasive role over antitrust scholars. Conventional economic theorists regarded these arrangements as departures from the ideal of perfect competition, thus seeming to confirm a similar resulting economic loss to those cartels which encompassed whole industries in the 1930s.[393]

However, in an evolutionary perspective, things look different. Naked price agreements, like other organisational forms, are the *spontaneous outcome* of competitive processes: Competition makes it possible for entrepreneurs to innovate, so they can eventually become the only suppliers of the new product they have decided to introduce onto the market. Later, successful entrepreneurs are imitated by others, increasingly the homogenisation of production. Production is in a constant state of unstable differentiation-homogenisation efforts on the side of entrepreneurs. Different corporate structures or organisations are devised to meet the demands of consumers for differentiated or homogenised goods, while the level of technology remains stable.

In other words, the optimum degree of diversification (or conversely, homogenisation) cannot be decided in advance by an omniscient authority. Firstly, reducing the degree of differentiation does not mean that it is necessary to reduce the number of producers. If it could be proven technically optimal to have one type of good, *it does not follow that it is optimal to have only one producer*. A cartel or a single

393 In fact, the introduction of antitrust policy in some key countries, like Germany, was sensibly addressed to prevent the re-emergence of industry cartels, which were frequently set up in that country before the Second World War to undertake government planning goals. They were rightly regarded by these scholars as threatening the emergence of a market economy in this country. See K. W. Nörr "Law and Market Organization: The Historical experience in Germany From 1900 to the Law Against Restraints of Competition (1957)", 151/1 Journal of Institutional and Theoretical Economics [1995] 5-20. Also, W. Möschel, "Competition from an Ordo Point of View", in German Neo-liberals and the Social Market Economy, A. Peacock and H. Willgerodt (Eds.), (New York: St. Martin's Press, 1989), pp. 142-159.

producer can equally do the job. A cartel is as efficient as a single producer in solving sub-additivity problems. Secondly, one cannot know in advance whether an activity deserves homogenisation because sub-additivity problems have to be solved. This has to be discovered by a trial-and-error process. Indeed, sub-additivity may change over time, and as new technologies are discovered, the position of the cartel may change over time, ending the need for homogenisation, and requiring product differentiation instead. As Earl contends, this may have to do with the stage of development of the market concerned.[394]

For this reason, Salin concludes: "It is preferable to abandon the definition of a cartel as an agreement between firms that intends to exert a restrictive action or any sort of specific action. The actual intention of participants is not relevant. Any action results from an intention, but the content of the intention does not matter from the market point of view. It may be that an entrepreneur enters into an agreement with some specific intention, but the outcome of the agreement is not the one intended, but another one which appears as beneficial, so that the agreement will be maintained. What is important in a cartel is that some mix of coordination-cooperation efficiently blurs the frontiers between organizational processes and market processes."[395]

394 In his words: "[Price competition] will vary depending on the stage of development of a market. In early stages in a market life-cycle, buyers may be poorly informed about the point of having the product and concerned about its likely reliability, and whether or not it is likely soon to become obsolete due to design improvements or due to its failure to be accepted as the industry standard. Later on, when the product has become increasingly homogeneous and when information about its design and manufacturing processes has leaked out and become widely known, brand names may count for little as signals of quality and reliability, and price competition may indeed be important. Even at this stage, it may still be questionable whether it makes sense to think of firms as enjoying given demand and cost functions, for changes in income levels may still be going on, and manufacturers of rival product types may be coming up with ways of winning customers back (as with the development of multiplex theatres by cinema chains, in the face of competition from the well established home video and cable television markets)". (Earl, p. 149.)

395 Salin, p. 42. Also see Rothbard, "Monopoly..." pp. 572-573.

ii) Mergers between competitors.

Again, mergers and acquisitions of firms by their competitors appear as reductions in the degree of competitiveness within the market concerned. Industries comprised of fewer firms, once mergers are undertaken, are placed further away from the ideal or equilibrium compared to those with numerous, smaller firms.

In our vision, however, mergers are strategies aimed at achieving entry into a particular field of production on a quantitative scale hitherto unattempted. Guided by the lure of making a profit, entrepreneurs seek to lower costs of production, management, marketing, and so on, by acquiring another competing firm. These profit opportunities may be sensed by alert entrepreneurs whenever already deployed productive assets are not fully exploited by less entrepreneurial competitors. This could occur if benefits from the use of those assets were improvable through a better managerial policy, by the exploitation of potential scale economies, or by an improvement in the coordination of resources. If the activities performed by the firms involved are closely similar, the firm interested in merging would have to incur no extra costs in adapting its capabilities to the activities undertaken by the firm subject to merger. The administrative costs of aligning competitors to achieve this coordination could be avoided by subjecting them to a single command. This would open up a gap which could, in turn, be wide enough to encourage more entrepreneurial firms to buy less entrepreneurial ones.

iii) Vertical integration and mergers between non-competitors.

Different levels of vertical integration simply reveal the extent to which the activities of the firms involved are complementary: the more complementary, the more integrated. Exclusive contracts can be similar to full vertical integration, where advantages for the co-ordination of complementary activities are obvious. Exclusive dealings simply require a more reliable business environment within which to distribute goods or services to certain customers. Similarly, exclusive supply contracts may require a reliability in supply or resources. Whenever the risks involved in the activity require it to be so, entrepreneurs can be inclined to pursue a more stable relationship by acquiring the management of a firm in an upstream or downstream market.

As long as competitive entry to third parties is not blocked, these will put pressure on integrating firms to be competitive and avoid "abusive" business behaviour against consumers.

iv) Price discrimination and other barriers to entry.

Price discrimination is impossible in markets characterised by perfect competition, where products are homogenous and demand functions are identical. Hence, entrepreneurs who engage in this type of business behaviour in "imperfectly competitive markets" are seen to force some customers and clients to pay in excess to what they "should", aided with the market power to impose such conditions. Similarly, antitrust condemns strategies oriented to raise "barriers to entry" (e.g., advertising campaigns to develop business reputation) which are aimed at differentiating markets.

In an ongoing situation, price discrimination may be a sensible strategy to differentiate between different sorts of perceived uninsurable risks. Entrepreneurs are faced with the fact that their ignorance on future conditions affecting their present investments makes them uninsurable. It is a risk that cannot be insured, since it is the result of sheer uncertainty and as such cannot be quantified.

The only way to provide for an uninsurable risk may be to adopt a strategy that would appear illegitimate to a conventional appraisal as, for example, the entrepreneur has to make allowances to cover any unexpected contingency. However, since uninsurable risk cannot be quantified, it cannot be included in costs. For this reason, the entrepreneur has to charge a price that appears to be above cost, but which simply reveals the fact that he lacks the information necessary to offset such unexpected contingency. If he did possess it, there would be no reason for him not to charge a lower price: a condition that would ensure a better chance of succeess *vis-à-vis* his competitors.

In fact, some industries require conditions of "structural" imperfect competition to exist, because start up costs are so high that limitations to entry may be necessary to justify the investment made. For instance, variable sales may also require profit over a short-term period to cover losses over another short-term period. In other words, perfect competition would lead to zero output.

Business reputation, on the other hand, provides useful information to those uninformed customers about the benefits of the product or service offered. This could be important in markets where the goods traded are "experimental", that is, where the customer can appraise the full qualities of the good once it is acquired.

v) Tying arrangements.

These arrangements entail commitments to buy and sell goods, at agreed prices, for a stipulated period of time. By guaranteeing a definite market to one producer, it therefore becomes closed to others; thus, the force of automatic selection is temporarily suspended. However, entrepreneurs are afforded predictability for future sales without an impairment to the other requirements for efficiency. Sometimes these agreements cover a variety of goods; in such cases, the conditions for automatic selection may be contravened, since a customer may prefer to buy elsewhere if free to do so, as in the case of tying arrangements. This is similar to a multi-product firm, which is able to practice internal subsidisation, and which is not subject to automatic selection in terms of each of its activities taken separately.

c) The balance of public policy analysis between short-term restrictions and long-term innovations and economic growth.

The restraints produced by organisational structures appear on the surface to be the very antithesis of the sort of freedom that drives unsuccessful entrepreneurs out of business; yet it is undeniable that they play an important informational role. The central question, therefore, lies in determining whether there can be a compromise between the functioning of these restraints, and the conditions of "freedom" which ensure market discipline and the selection of productively efficient firms.[396] Public policy has a trade-off to make between the restriction introduced which limits both market discipline and efficient selection in the short-term, and the information that the arrangements bring about in the long-term, which will encourage productive investments. Policy-makers are thus confronted with the question of whether the endurance of these restrictions is justified over time, given the economic landscape of the industry in which they are implemented.

It is necessary to realise that these arrangements cannot be considered "restrictions of freedom" as such. Freedom is only obtained when entrepreneurs have alternative courses of action available. In the conventional appraisal there is no such freedom. Forcing the entry (or endurance) of more firms into an industry than it can naturally tolerate with the aid of regulatory devices would do away with the freedom of those affected by the prohibition placed on their actions (to buy and sell, set whatever prices they regard as convenient, insure their businesses from unexpected risks, and so on) and would not compensate those firms which have suffered any loss of freedom. Indeed, these would have no more freedom to decide any given course of action. Any decision would now depend, not on their own will, but on the existence of the regulation imposed.

For this reason, Salin believes that the use of the term "restriction" for such barriers or impediments to competition is misleading, because it compares them with a non-restrictive standard, which in this case is impossible. In an imaginary world this standard would be the existence of perfect information among producers, which would allow them to avoid inconvenient restrictions on their freedom, otherwise necessary to overcome any problems in obtaining information concerning future demand.[397] Thus, when the time factor is considered, present contractual (or formal) constraints over future action *cannot*

396 In the words of Richardson: "There would seem to be a need that the markets of individual producers should be both secure, in order to give them the confidence to invest, and at the same time vulnerable, lest their policies are inefficient or restrictive. Must we admit this incompatibility to be genuine and ineluctable? Is it possible to find a compromise between the conflicting requirements, an optimum degree of inertia or restraint, which will best favour the process of resource allocation taken as a whole?" (Richardson, Information ..., p. 120.)

397 Salin, p. 34.

be seen as restrictions on competition or on freedom, but as means of ensuring expectations and ensuring access to valuable information on profit opportunities.

For this reason, these seeming "limitations on freedom" which enable some firms to seize profit opportunities, cannot last indefinitely in a voluntarily negotiated setting. In such an evolving setting, the restrictive effects of these arrangements are irrelevant because they create the conditions favourable for their own elimination. As time passes, new circumstances render these agreements obsolete. This erodes their use as conveyors of useful information on how to meet consumer demand (and therefore, how to make some profit). Knowledge gaps resulting from the obsolescence of former conventions-solutions will encourage alert entrepreneurs to make new ones, and thus seize the new profit opportunities created.

Different organisational forms enable information to reach *some* market participants, at the expense of restricting the freedom of the participants, but at the same time, enhancing their possibilities for them to receive such profits from others. Therefore, it will encourage them to make further investments. In the words of Richardson, "these market connections, *whatever the additional objectives for which they are designed, and whatever their indirect effects*, do afford entrepreneurs a more secure market for their individual products. They serve, in other words, as a means of increasing the amount of market information in a decentralised economy, or, in other words, of increasing the predictability of the entrepreneurial environment". Thus, "the availability of [the] kind of information related to competitive production depends in particular on the existence of restraints which, in varying degree, reduce the freedom of action of individual entrepreneurs". (Author's italics)398

For this reason, they can be regarded as efficient in the sense that they ensure firms a profit which would otherwise be impossible to achieve for anyone, and would therefore be lost. Again, a profit made available to all is lost by everyone. *Without them, market co-ordination would be impossible*, and producers would certainly be prevented from

398 Richardson, Information ..., p. 68.

making new discoveries, innovation, and related improvements which in the end benefit consumers. In other words, these advantages would accrue only if we allow a particular entrepreneur to restrict his freedom of action so as to enable everyone else to have some predictability about his future actions; a condition which, under a static appraisal, appears to be a restriction on rivalry in the market.

Only in a long run can one clearly see that these organisational forms are constantly threatened by innovation from other firms providing substitute products. Innovation itself is triggered by the promise of receiving profits for creativity, which leads to output expansion in the long run. *Clearly, removing all profits would be efficient from an equilibrium point of view, but would threaten innovation and so would be less efficient in the long run.* Innovation has transition costs, and restrictive policies with the old product or technology may ease the transition and spread the costs (retraining, unemployment, etc.) over time. In a long term appraisal innovation, will render these arrangements obsolete.

The differences in foresight, or the capacity to increase production that enable entrepreneurs to gain an advantage over their competitors are transitory. In a dynamic setting, "the impact of new things – new technologies for instance – on the existing structure of an industry considerably reduces the long-run scope and importance of practices that aim, through restricting output, at conserving established positions and at maximizing the profits accruing from them. We must now recognize the further fact that restrictive practices of this kind, as far as they are effective, acquire a significance which they would not have in a stationary state or in a state of slow and balanced growth."[399]

Obviously, under a perspective that visualises markets as something static, where resources are given and no discovery arises, all these techniques appear to limit the opportunities open to entrepreneurs for taking "independent" paths, and indeed in this sense, they are "restrictive". In the process of ensuring customer loyalty entrepreneurs may attempt several strategies which third parties (i.e. antitrust authorities) could

399 Schumpeter, p. 87.

interpret, following a *structural* logic, as "market foreclosures" imposed against other competitors. Similarly, a structural logic would condemn the strategies aimed at seeking information from other competitors because this would align everyone's conduct, thus reducing the number of effective rivals within the market. But again, this is a matter of the perspective endorsed. As Lepage contends, "...a number of business conducts traditionally regarded as 'restrictive' and deemed incompatible with the needs of a healthy competition are nothing else but private contractual arrangements purporting to improve market functioning (particularly to reinforce the loyalty of the participants in the transaction) [and competition]".400 Under a conventional perspective, the essential question concerning the co-ordination of entrepreneurs (both competitors and clients) to make future information (as yet unknown) available and to forestall future losses resulting from forecast errors is totally neglected.

Hence, implementing a policy designed along those principles would inhibit entrepreneurs from undertaking investments, developing innovations and creating economic growth. Evidently, this is particularly relevant to the design of public policies in developing countries such as those in Latin America. Intervening in the conventional way would destroy the growth of knowledge that the system would otherwise produce. That means products will never be created, markets will never be developed, jobs will be foregone, business opportunities missed, etc.

Similar reasoning justifies organisational structures which restrict short-term rivalry to enhance long-term discoveries. Thus, appraising the proper length of these arrangements is crucial. The question, of course, is can a third party (i.e., a policy-maker) identify what short-term restrictions should be challenged and what should be tolerated in order to pursue long-term, socially-valuable discoveries?

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400 H. Lepage, La nouvelle èconomie industrielle, Pluriel (Inédit), Hachette-Librairie Générale Francaise, Paris, 1989, p. 231 (unofficial translation). Lepage also adds: "Ce que l'État considère généralement comme des entraves ou des atteintes à la concurrence, n'est le plus souvent que le résultat des procédures utilisées par le marché pour résoudre précisément les problèmes d'efficience et de loyauté qui servent de motif à son intervention". (Lepage, La nouvelle..., p. 233)

Probably not. Only the entrepreneur's subjective appraisal of the productive activity concerned is capable of determining whether the kind of organisational structures negotiated extend beyond its proper limits. Thus, it is not possible for anyone outside the transaction to identify the boundaries of the firm objectively. Only those entrepreneurs involved can do so, and at the risk of being wrong. Government rules should not attempt to discover what these "proper" limits are, but leave individuals to find them, at the peril of making their own mistakes.

Therefore, in the real world, which is the world that policy-making is supposed to address, it is necessary to acknowledge that it is not possible to determine which business activities should be subject to rivalry and which should be subject to vertical integration. Only entrepreneurs can have different opinions about the degree to which an economic activity is complementary or competitive.[401] Thus, they are able to develop subjective appraisals of market participants, at times identifying them as competitors, and at times seeing them as potential customers or suppliers. As the process of competition is aimed at increasing information and knowledge, this sometimes leads to rivalry among market participants but in other cases it leads to co-operation.

Public policy should instead define those instances where entrepreneurs are prevented from voluntarily defining the limits of market organisation. This could happen,

401 There is no clear-cut distinction between competitive and complementary investments. In the end, it is the consumer's subjective perception based on their preferences, which determines what entrepreneurs will come to regard as complementary and what as competitive. Neo-classical demand theory assumes that consumers can order their preferences as different combinations from a fixed list of commodities: the logic of choice. Entrepreneurs, however, have to determine what combination of qualities goods must possess; therefore, the model of consumer behaviour does not suit. (Earl, pp. 144-155.) Certain commodities may possess alternative uses which consumers must decide upon. Preferences between various commodities are not just 'given' to a consumer; they have to decide by weighing up the contributions made by each of them with their own objectives. It is not preferences between goods, but stability *over time* which characterises the various desires that goods meet: some desires demand changing commodities for their satisfaction (novelty); desires also require social distinction because the possession of a commodity offers prestige when confined to a few people. Consumers buy because of the preferences they expect to get. It is a trial-and-error process. In short, consumers are endowed with a set of desires and form their preferences for commodities on the basis of their imperfect knowledge of the power that the commodities have to satisfy these desires. Entrepreneurs are constantly trying to "guess" the opinions and tastes of consumers, in order to point their activities in a particular direction.

for instance, if a gap in the legal protection of these rights or defective official enforcement encourages other entrepreneurs to missapropriate business reputation (i.e., violation of copyrights or trademarks). More significantly, government regulations could distort the growth of economic organisation by dictating entrepreneurs how to behave in the market. Public policy which aims to preserve competition should focus on either challenging market restraints, which are sustained by a legal source or challenging the legal source itself.

Hence, it is possible to conclude that in a dynamic evolving framework, rivalry and co-operation do not really "oppose" each other, but form a complex game in which managers sometimes engage in rivalry and sometimes co-operate, according to the level of differentiation they observe in the activities, products and services offered by a particular cluster of firms within the market. Only in a static framework does it appear that both forms of relationship between firms and markets are contradictory and incompatible. In a dynamic framework, what appears essential is the competitive entry of any entrepreneur to be ensured, by eliminating all sources of legal privileges preventing access to the market.

In conclusion, individuals exercise their property rights and freedom of contract by arranging their affairs and entering into association with other individuals thus creating a wide array of corporate structures and business practices set up to meet their objectives and enhance their mutual business expectations. If not constrained by external interference and legal privileges, these structures represent the best possible state of affairs to their members, within the limits of their access to knowledge and available technology, and their functioning leads to the efficiency of the spontaneous market order.

d) <u>Some empirical evidence about the informational role of organisational arrangements: The Latin American experience.</u>

The Latin American experience clearly supports the theoretical appraisal outlined above. The available empirical evidence highlights how the official constraints placed on the growth of business as a result of development policies induce firms to implement subtle forms and strategies of management co-ordination. It also shows that the reality of Latin American domestic markets, frequently small and with little purchasing capacity, induces firms to seek strategies and arrangements that may seem, in principle, suspicious to an antitrust authority.

Since economic reform was launched in the 1980s, numerous industries have suffered a "managerial revolution". *Apertura* has prompted the emergence of innovative firms in the region, despite the appearance of increased concentration in some markets. In the words of Gómez: "For Latin America, these are revolutionary times. Market-oriented policies are breaking down barriers that until recently enclosed weak, undersized, and heavily regulated economies. Privatisation, deregulation, and reduced trade restrictions are replacing state monopolies and private cartels. Foreign investment drawn from outside the region is being matched locally by unprecedented flows of capital as Latin American firms purchase their neighbour country companies, enter new markets, and forge networks of strategic alliances throughout the hemisphere. Information technology, combined with the privatisation of state monopolies in telecommunications, is boosting the flow of data triggering linkages between financial markets across countries. For the first time, concessions and other market mechanisms are being employed for managing port facilities, building new highways, expanding airports, and upgrading long-neglected infrastructure. To be sure, progress varies from one country to another; but history may well mark the 1990s as the decade when Latin America pulled itself together".[402] He concludes: "What clearly stands out in assessing the growing internationalization of Latin American firms is the innovative approaches that many employ".[403]

In this respect, the INTERMAN Management Innovation Programme has identified several features that summarise many of these new and innovative forms of doing business in Latin America. These features have evolved out of the institutional uncertainties surrounding business activity in the region, which in part arises from problems created by the lack of infrastructure for trade in Latin America. In particular,

402 Gómez, p. 226.

403 Gómez, p. 245.

the lack of global channels, favourable logistics, and information technology has forced firms to seek ways to overcome these constraints. Gomez comments: "In Latin America, securing adequate distribution for consumer products can represent a challenging management task; logistics represent more of a barrier than a driving force; and information technology, including communications, has only recently begun to contribute to internationalizing the region's business".[404]

Furthermore, the lack of certainty and reliable expectations about legal regulation has often made Latin American firms turn to alternative means of enhancing their expectations than those conventionally acknowledged in business practice elsewhere. The problems of currency volatility and about-turns in economic policy experienced in the region have frequently caused havoc in the management of multinational firms. For these reasons, to offset the uncertainties of official decisions, firms in Latin America resort to a variety of devices to ensure their markets. For example, they use family ties in business, seek more flexible management, use informal links, and develop a managerial capacity for influencing official institutions to create more predictable and reliable Government decisions.

For example, family links often provide a reliable source of mutual trust in business. As Dávila and Gómez Samper argued in a study they conducted on Latin American management: "[the majority of Latin American-owned innovative firms are medium size (i.e. employ from 300 to 800 persons), are often family run, and have proven proactive vis-à-vis the region's economic, social, and political turbulence".[405]

Making business relationships flexible, so as to "open" them to changing circumstances, has also proved efficient in this context. Gómez explains the conclusions of a study on highly successful Latin firms, which revealed a degree of informality in management styles in some Brazilian, Colombian and Venezuelan organisations which

404 Id., p. 234.

405 C. Dávila and H. Gómez, "Innovative Management and Organizational Development in Latin America", 36 The International Executive [1994], p. 675.

differed from the explanations formulated by conventional theories. The informality is related in these cases to "novel property and organisational structures, effective empowerment strategies, unconventional organizational missions, and deliberate efforts to build on culture-specific idiosyncrasies".[406]

Using informal links has also become important in reducing uncertainty. "For some Latin American firms, making good use of the informal market became a way of building the home market as well as export sales. *Canels*, for example, has become Mexico's largest chewing-gum manufacturer by focusing its distribution effort largely on the informal sector. *Leonisa*, a Colombian lingerie manufacturer, came to dominate the market with its product line in nearby countries chiefly by building and carefully monitoring, in each country, its informal-sector wholesale and retail network".[407]

Moreover, leading firms have in some cases developed alliances with counterpart firms in neighbouring countries as a way of breaking into each other's market. For example, multinational companies frequently buy local firms with an established customer base. Switzerland's *Nestlé* recently acquired Venezuela's *Savoy*, a large local firm with a firm reputation in the Venezuelan confectionery market. *Alpina*, a Colombian firm, initiated exports of its dairy products to Venezuela by reaching a mutual marketing agreement with *Plumrose*, a Venezuelan meat processor. Commenting on this operation Gómez contends that "both firms produce premium quality products, and both benefit from the agreement by relying on each other's extensive retail distribution network, rendering channels more efficient by adding new and complementary lines".[408] Once established, they then expanded their operations in the new market. Alpina acquired a new plant after obtaining consumer acceptance. In another case, *Mavesa*, a Venezuelan food processor, and Colombia's *Noel*, followed a similar start-up strategy.

406 Gómez, p. 244.

407 Id., p. 234.

408 Id., p. 235.

Another example of developing business links with local partners is *Sky Latin America LLC*, a regional satellite television enterprise based in Miami, which has developed joint ventures with firms like *Organizacoes Globo* in Brazil and *Grupo Televisa S.A.* of Mexico in order to gain a foothold in these two Latin countries. This has been taken as a first step towards the expansion within in the region with the aim that *Sky will* eventually outdo its competitor –and leader in the market.– *Gallaxy Latin America*. *Sky* has created independent operations in each country, leaving marketing and sales strategies to its local partners.[409]

Proliferating mergers and joint ventures are not necessarily the result of a manifest (or implied) intention to monopolise regional or local markets. There are two reasonable explanations for such operations. Firstly, there may well be a need to overcome the uncertainty of investing in the newly emerging markets of Latin America. This need may induce firms wishing to take advantages of the liberalisation in the region to forge closer business ties with other firms, offering them tacit and subjective knowledge of the new market, which they would otherwise require years to develop. Secondly, these concentrations may occur because of the need to ensure sufficient economies of scale to make the investment profitable. Indeed, the size of domestic Latin American markets, independently considered, may not support investments above certain levels.

For example, the *Sindicato Antioqueño*, a Colombian group representing some hundred independently-owned firms, and including some of the country's largest and most advanced retailers, joined Holland's *Macro* and Venezuela's *Polar* in order to bring about Venezuela's largest chain of supermarkets (fifty *Cada* outlets) and department stores (eight *Maxy's* stores). The new chain of supermarkets and department stores, together with the *Macro* bulk retail outlets that are expanding rapidly in Venezuela, provide a powerful, ready-made distribution channel for the *Sindicato's* wide range of manufacturing firms, including *Noel*. Once on the brink of bankruptcy, these firms have been revitalised by the new capital and "knowledge" provided by their new partners. The old owners, the *Cisneros Group*, divested themselves of both the *Cada* and *Maxy's* retail

409 T. Sullivan, "El Desafío de Competir" América Economía, 9 April 1998, p. 54.

networks in order to raise the vast amount of capital required for their hemisphere-wide entry bid into satellite television.410

Corporate restructuring may prove decisive in a rapidly changing business environment. The example of *Grupo Hermes* provides clear evidence of this. This formerly protected Mexican industrial group survived the 1994 recession and foreign competition by selling its interests within the manufacturing sector and focusing on the energy sector and telecommunications. The group is now the main shareholder of *Grupo Cerrey,* which produces energy plant containers. By this, the group was able to build on its previous manufacturing experience of automobile parts.411

For complementary investments, some local multinational companies contract the services of domestic firms ("outsourcing"), rather than developing internal units or vertical integration. By doing so, these firms acquire the knowledge and expertise to develop export sales. For example, *Cartonajes Estrella,* a leading carton maker in Mexico, obtained a contract to supply cups to McDonalds and soon afterwards began servicing the firm's needs in Costa Rica, Ecuador, and Argentina. Another carton supplier, *Convermex,* also supplies McDonalds, as well as KFC, Domino's Pizza and other fast food suppliers in Mexico and elsewhere in the region. As Gómez indicates, "by serving as local suppliers of multinationals, these Mexican firms learned how to cater to customers that demand consistent quality, low prices and large volume".412 Another case is the experience of *Alicorp, S. A.,* a large Peruvian food manufacturing company. This company regards its distribution network system, based on effective outsourcing, as the key to its success over its competitors. In 1993 the company began an aggressive expansion plan, which included buying its two most important rivals, thus reducing costs –payroll was reduced by 43%–, and developing a reliable distribution network. The results: in 1997 the company's turnover was estimated at US$600 million a year, compared to US$120 million in 1993. Outsourcing enables *Alicorp* to reach clients that it

410 Gómez, p. 235.

411 Sullivan, p. 52.

412 Gomez, p. 235.

would otherwise be too expensive to serve, because its distributors have lower cost structures. In this relationship, *Alicorp* provides its distributors with capital, know-how and access to its network of clients.413 A similar business strategy explains the success of *Polar*, the largest Venezuelan brewery, which has survived *apertura* and foreign competition because of its excellent distribution network system.

The pressure of internationalization has forced Latin firms to either seek alliances or integrate in order to meet the challenge of international competition. A good example of integration is the Mexican cement industry, formerly dominated by dozens of family owned companies spread across the country. Once trade barriers came down, small companies were absorbed by Mexico's *Cemex*. This company is now on a par with the three Swiss, Italian and French multinationals that, together with *Cemex*, dominate the world cement market. By contrast, steel producers provide an example of alliance. Firms in this industry have remained largely independent, but this has not prevented them from developing strategic alliances for solving specific problems, such as the imposition of dumping duties in foreign jurisdictions. Steel producers from Brazil and Chile were brought into a newly privatised Argentine firm to create *Aceros Paraná*, the first steel-producing firm to form part of a regional group. In Mexico, *Tamsa* entered a strategic alliance with Argentina's *Siderca*, which is part of the *Paraná* complex.

On other ocassions, rather than keeping the cash from official devaluation, firms have chosen to invest it in non-depreciable assets. *Unilever*, for example, acquired several Mexican firms, boosting its sales from US$80 million in 1985 to US$610 million in 1992.414 Sometimes, strong investments in technology may be necessary to reduce labour costs, as the example of *Companhia Textil de Minas Gerais, S.A. (Coteminas)*, a large Brazilian textile manufacturer shows. An investment of US$450 million in machinery enabled this firm to compete successfully with Asian rivals, whose labour costs are 50% lower.415

413 Sullivan, p. 56.

414 T. Brädacke, "Comprar Mucho, Vender Más", América Economía, (1993-94) Special Issue, p. 56.

415 Sullivan, p. 58.

Gómez vividly describes the challenges which lie ahead in the process of corporate integration in the region: "Early in the coming century, [it is] conceivable [that] the food marketer's dream could well come true: millions of consumers throughout Latin America, prompted by a region-wide, satellite-beamed advertising campaign, begin each day drinking the same brand of juice (or soft drink) and the same breakfast cereal!"[416]

Finally, in order to remain efficient (i.e. adapted to the Latin American setting), these forms of co-ordination have encouraged firms not to grow too fast or too much, and not to adopt values which run counter to conventional business. As an example of the first situation, Dávila and Gómez relate the case of *Ekare*, a Venezuelan children's book publisher, which has attained world-class stature based on the excellence and originality of its product brought about by avoiding excessive growth. To explain the second situation, they quote the case of *BICE*, a medium-sized Chilean bank, which is part of a powerful business group has become a leader in fiercely competitive corporate and institutional banking. The success of this bank, in their opinion, is based on local cultural values; in particular, a personal selection process built on family unity and religious values that would be considered "unthinkable" in a modern business setting.[417]

To sum up, the evidence presented above supports the conclusion that businesses regard predictability as essential in their transactions. As a result, they attempt to increase their certainty, even at the expense of restricting the possibilities for action, if that can enhance their expectations of the reliability of the market where they are planning to invest. One should not forget that market arrangements are shaped by the structural conditions of the markets involved, and that these conditions (the technologies involved, legal rules, customs, economies of scale, and others) cannot be dismissed in the appraisal of such restrictions.

416 Gómez, p. 242.

417 Dávila and Gómez, p. 657.

3.- DEFINING THE AGENDA FOR THE PROMOTION OF COMPETITION PROCESSES IN LATIN AMERICA.

3.1.- The role of governments in promoting competition processes.

The next question to be addressed is whether public policy fulfils the role of enabling the process of discovery of valuable information. To begin with, governments should create the conditions necessary for the growth of creative entrepreneurial talent and the development of new products and markets, which is what competition is about.

Hayek gives us a first appraisal of how governments should proceed to achieve these aims: "Policy need not be guided by the striving for the achievement of particular results, *but may be directed towards securing an abstract overall order of such character that it will secure for the members the best chance of achieving their different and largely unknown particular ends*. The aim of policy in such a society would have to be to increase equally the chances for any unknown member of society of pursuing with success his equally unknown purposes, and to restrict the use of coercion (...) to the enforcement of such rules as will, if universally applied, tend in this sense to improve everyone's opportunities". (Our emphasis)418

This institutional appraisal defines a two tier level of rules, which emerge at different speeds: firstly, there is a level of social rules which provide a stable shelter of predictability within which entrepreneurs may adapt their particular businesses and secondly, there is a level of rules that emerges from the commercial routines and practices of immediate market interaction. The responsibility for keeping the first level updated and adaptable to market needs is essentially (albeit not exclusively) in the hands of governments, whereas the second is essentially defined by entrepreneurs in their dealings. Changing circumstances make the second level bound to experience more frequent changes, as entrepreneurs develop and adjust the boundaries of their relations with other entrepreneurs, both at a competitive and complementary level. By contrast, the level of

418 Hayek, Law, Legislation and Liberty: The Mirage of Social Justice, p. 114.

general rules tends to evolve at a slower pace, since its materialisation depends on the cumulative social learning process brought about by failures and successes of particular experiences.

Therefore, striving for the accomplishment of particular "social welfare" goals at the first level of general rules is in fact a difficult, if not impossible, task to achieve. Institutional "efficiency" lies elsewhere, i.e., in the coordination that social rules bring about through the cumulative learning experience that they entail.

The problem, once again, lies in the informational limitations of distant authorities, compared with the ability for closer appraisal possessed by those parties actually involved in the transaction subject to regulation. This appraisal is an entirely subjective approximation to reality in the hands of entrepreneurs.

As we have indicated in the previous chapter, the mathematical tools used by regulatory authorities to quantify *objective* cost-benefit appraisals of the regulations they implement are useless for giving information on the legal rules of "open-ended" market order. By contrast, individuals *are always perfectly aware* of the (subjective) opportunity costs involved in a particular situation, even if they cannot quantify the magnitudes involved.[419]

This is not to say that general rules can eventually achieve an "optimal" point of efficiency in this task. Indeed, in deciding which organisational structures they should choose to meet their needs, even they do not know for sure what activities they need in order to integrate with other individuals, or for how long. Managers are neither

419 As Mayer contends: "In essence there is an immanent, more or less disguised, fiction at the heart of mathematical equilibrium theories: that is, they bind together in simultaneous equations, non-simultaneous magnitudes in genetic-causal sequence as if these existed together at the same time. A state of affairs is synchronised in the 'static' approach, whereas in reality we are dealing with a process. But one simply cannot consider a generative process 'statically' as a state of rest, without eliminating precisely that which makes it what it is" See, H. Mayer, "The Cognitive Value of Functional Theories of Price: Critical and Positive Investigations concerning the Price Problem", in Classics in Austrian Economics: A Sampling in the History of a Tradition, I. Kirzner (ed.), (London: William Pickering, 1994), p. 92.

omniscient decision-makers, nor immune to mistakes; they are subject to the natural limitations of human knowledge. However, it is still easy to see that entrepreneurs are better suited to appraise the particular circumstances involved in any given transaction. The closer individuals are connected to the situation whose uncertainty they wish to control, the more likely they are to succeed.[420]

Evidently, this is a question which depends upon the subjective perception of the individuals concerned. The closer individuals are to the situation at hand, the more they will know about it, and the less "open" the rules will therefore presumably be. On the other hand, if individuals are distant, they will obviously have to leave their commitments more "open" to incorporate any new knowledge, which is unavailable at that particular time. There is no way in which governments can acquire sufficient information to decide the "right" size or composition of markets. As Foss argues "it is not possible to discriminate among different kinds of economic organization on grounds of efficiency under full information and no uncertainty; one kind of economic organisation is as good (efficient) as any other kind."[421]

The virtues of general rules lie in the accumulated knowledge that they create, which enables the authorities to decide, without being constrained by their knowledge, the limitations of a particular situation, simply because the specifics are circumvented in the decision making process. As Rizzo predicates: "The need for rules is predicated on our ignorance (...). Rules must therefore be applied in particular cases regardless of the hypothesized or 'guessed-at' consequences. The very unpredictability of these consequences requires adherence to the given rule. If the law cannot systematically achieve specific social goals, then the best it can do is provide a stable order in which individuals are free to pursue their own goals. The unpredictability of a rule's effect in a

420 As Hayek contends: "If we agree that the economic problem of society is mainly one of adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them." (Hayek, "The Use of Knowledge...." pp. 83-84.)

421 Foss, "Capabilities..." p. 6.

concrete situation is the price we must pay to achieve the predictability of the abstract order".[422]

At the same time, following a set of general rules does not subject the whole system to stagnation. The cumulative learning process embodied in emerging general rules never ends, due to the very essence of the discovery process. They provide a stable shelter of predictability within which entrepreneurs may adapt their particular businesses, but which acts as a shelter in constant flux as well.

By contrast, purposive "conventional" regulation, which assumes the full knowledge of the decision-making agent (whether the authority or the entrepreneur), neglects the possibility that these decisions may fail to achieve their goals due to ignorance and insufficient information. Individuals may come to realise ex-post that the information they had, which induced them to adopt a certain course of action, was insufficient or misleading. But the possibility that individuals realise their failure *ex-post* does not justify *ex-ante* government regulation of the economic activity concerned. To begin with, processes of trial and error merely provide a hint about which solutions can be successful in the future; they never provide full certainty. Once more, unforeseen events may arise at any time which render former solutions obsolete. Therefore, ex-ante regulation will inevitably be too rigid to address unforeseen circumstances.

Governments should therefore acknowledge these limitations by enabling individuals to negotiate freely the institutional arrangements which they believe will reduce their uncertainty. In this way they can do a great deal for improving institutional conditions which introduce unnecessary curtailments of social knowledge, thus enabling firms to be spared from these.

Individuals interact in the market through complex corporate forms, which co-ordinate their activities to achieve their production goals. Freedom of contract enables them to arrange their affairs as they see fit, giving rise to firms of varying shapes and

422 Rizzo, "Rules versus...," p. 873.

sizes. Contractual freedom enables individuals to create whatever corporate form they consider necessary to achieve "institutional efficiency", i.e., *they can reach their individual goals through a mixture of rivalry and co-operation*. This provides them with the best information they can possibly have to arrange their affairs.

Public interest in the context of open-ended economic systems requires the fulfilment of the economic expectations of market participants. This does indeed require government intervention, but intervention with a sign that it is different from the conventional one. Government initiatives should ensure that pattern co-ordination evolves along its natural course, and that individuals are not forced to take specific routes which they would otherwise rather not to accomplish their efforts at discovery. In other words, governments should refrain from setting up legal rules that undermine the expectations of those better placed to process the complex body of information generated by the social system, or challenge whatever arrangements they envisage will allow such information to be gathered most expediently. Of course, other values may also guide the enactment of laws and policy enforcement, but that is quite a different matter.

In the realm of competition policy, setting up the right framework for spontaneous pattern co-ordination to stimulate free competition requires fulfilling two essential conditions. First, policy-makers should acknowledge the institutional efficiencies brought about by restrictive arrangements aimed at finding disperse information in the system. These arrangements generally aim to make information available that is necessary to improve social welfare and promote competition processes. Therefore, a policy aimed at enhancing competition should certainly not challenge or undermine these arrangements, but should confine itself to condemn arrangements that are solely based on the intention to extract rent from consumers. However, this is not an easy task, as Wiseman observes: "...the fact of uncertainty makes the association of competitive behaviour and profit maximisation, on which the market-economy model depends, less generally acceptable. The desire to reduce uncertainty by gaining control of the uncertain variables must be an important motive in attempts to eliminate competition. Uncertainty thus implies the need for positive government policy to ensure *competitive* behaviour in pursuit of profit maximisation, since only such behaviour conduces to an efficient distribution of resources. *The difficulty in framing such a policy lies in distinguishing those factors which are the inevitable accompaniment of ignorance and uncertainty and those which arise simply out of a desire to maximise net revenue in an environment characterised by these things*" (Author's italics).423 Consequently, if the goal is to enhance the level of efficiency of markets, measured in terms of new discoveries of valuable information (i.e. innovation, technological progress, etc), then the legal system must be supportive of individual decisions to develop particular "rules", "patterns" or "institutions", "corporate forms" or "levels of contractual integration", which enable the process to unfold as much information as entrepreneurs are capable of discovering.

However, as we shall see, many of these arrangements are prohibited under Latin American antitrust statutes. Secondly, policy-makers should eliminate any regulatory constraints placed upon society on the basis of utilitarian goals, such as maximising efficiency. Such regulations may erect contrived barriers which prevent firms from discovering valuable information.

Attempts to impose a particular social welfare measure are likely to diminish the efficiency of each individual, and consequently the efficiency of the system in general in achieving social goals. Imposing interpersonal values as measures of social welfare, using legislation as an instrument, will simply distort the "order" created, thus reducing the performance that society could otherwise achieve.

Routines, rules and other forms of organisational structure express, in different terms, a similar appraisal of economic systems. This is a role inherent in the function that rules perform in eliminating uncertainty which would otherwise obstruct the investments needed to foster future exchanges. We adhere to rules because, given the impossibility of forecasting the future, this is the most efficient course of action. Firms adopt rules and routines in order to enhance their chances of acting efficiently on an ongoing basis within reality. Organisations fulfil the crucial role of providing entrepreneurs with sufficient foresight to enable them to adapt to the evolutionary setting where they are required to

423 Wiseman, Uncertainty..., p. 234.

make their investment decisions. In short, social institutions, such as the complex web of shared information that we know as "the market", allow entrepreneurs to reduce their sheer uncertainty to a point where they will feel encouraged to trade their property rights: as essential factor in fostering economic development. According to Hayek, legal certainty is probably the most important requirement for the economy of a society and has contributed much to the prosperity of the Western world.424 North agrees that institutions are essential for promoting economic development.425 Policy-makers also acknowledge the positive effects on economic performance of reducing the "costs of doing business".

Markets emerge spontaneously as an integrated network of rules devised by their participants, whose existence is justified by the need to find solutions to the new and recurrent problems created by ever-changing information. Such changes in the subjective perceptions of entrepreneurs enable them to see knowledge gaps unseen by other entrepreneurs, and to therefore forecast profit opportunities, which they attempt to seize before the others. These gaps encourage them to compete as long as they feel they can outdo their rivals, provided they are sufficiently alert. Whenever an alert entrepreneur discovers an information gap, thus identifying a profit opportunity, profits may not materialise (in which case, it is as if no discovery has been made) unless our single entrepreneur seeks co-operation with others. Finally, these gaps can sometimes be seized and exploited only if firms give out alternative choices to those with whom they must trade in order to make the opportunities real.

For these reasons, comdemning organisational structures embodied in business strategies because they restrict rivalry in the market could be a misjudgement of their economic rationale. This could also lead governments to impose losses on society,

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424 F. A. Hayek, The Political Ideal of the Rule of Law, Fiftieth Anniversary Commemoration Lectures, (Cairo: National Bank of Egypt, 1955), p. 36.

425 D. North, "The New Institutional Economics and Third World Development", in The New Institutional Economics and Third World Development, J. Harriss, J. Hunter, C. Lewis (Eds.), (London: Routledge, 1995), p. 18. Also, D. North, Institutions, Institutional Change and Economic Performance, (Cambridge: Cambridge University Press, 1990.)

because it could induce them to prevent (or make costlier) the exploitation of valuable information, and distort future processes of information discovery.

As a result, one should not draw hurried conclusions from the varied arrangements which comprise markets without understanding the context of evolutionary and changing information within which they are placed. By assuming perfect knowledge, the conventional paradigm assumes away the main problem faced by entrepreneurs, which is their decision to integrate and cooperate with many "restrictive" forms in order to insure them against the factor of sheer uncertainty. By adopting an evolutionary institutional perspective, these arrangements appear as the outcome of differing and unavoidable levels of knowledge handled by different entrepreneurs.

The need to develop regulations which fit the needs of entrepreneurial discovery is all the more important if one considers the need to ensure effective compliance with them by those who are subject to them. This is particularly relevant in the case of those countries possessing weakened official institutions incapable of effectively ensuring compliance with the rules laid down by the Authority.

As we have indicated above,[426] ignoring or neglecting official regulations is entrenched in the culture of Latin American effective institutions. It is therefore essential that policy-makers do not attempt to curb market functioning on the basis of aiming to achieve outcomes which, as we have seen, are not even subject to commonly agreed standards. It is not only a question that policy-makers will be uncapable of defining social welfare goals accepted by all, or even that they will be misled by their closed-end appraisal of market interaction. Optimal regulation will never be so if it cannot achieve its aims due to the resistance of those subject to it. This is, again, all the more important in Latin America, because of the cultural values impinging upon the enforceability of official rules.[427]

426 See Chapter 2, section 1.2, above.

427 On this question, Voigt emphasises the significance of "preconstitutional" values in ensuring the effective credibility of constitutional rules. He claims that this is a factor absent from the Latin American reality, thus leading these countries to disregard the rule of law, which leads them into economic backwardness. See S. Voigt, "Making Constitutions Work: Conditions for

If competition is designing incentives to put firms under the constant threat of being driven out of the market if they fail to discover or exploit useful information, competition policy should ensure that firms are not prevented from making their own discoveries and exploiting opportunities whenever they have the possibility of doing so.

Clearly, a policy committed to these goals should take account of the need to maintain business expectations which are immune from the distortions of Big Players within the system. For this purpose, two conditions are necessary: firstly, the allocation of property rights must be improved, so that economic agents gain effective access to social resources. Secondly, political actors must be subject to effective control and accountability to ensure that their activities do not erode the property rights already allocated. We now turn our attention to these problems.

3.2.- Setting the agenda for the promotion of competition.

Eliminating all sources of disruption to market order is fundamental for enhancing the certainty of entrepreneurs about the return of the investments they make in the market. The need for "legal certainty" in the market process requires control of unpredictable political processes which could cause possible distortions in the system. It also requires control of the business practices that diminish those expectations.

There is a growing consensus that "competition advocacy" may become an efficient tool for promoting the functioning of markets, at least on equal terms with conventional antitrust intervention.

Current literature defines the role of competition advocacy narrowly as a small range of activities which complement the core of antitrust activity, circumscribed to deregulating the barriers to competition created by state intervention. In this sense competition advocacy almost appears as an addendum to the fundamental activity carried

Maintaining the Rule of Law", 18 Cato Journal, (1998): 191-207.

out by antitrust agencies, mostly oriented to the prosecution of anti-competitive business conduct.[428].

This appraisal should come as no surprise. Competition advocacy has always been of marginal importance to antitrust enforcement compared with other areas of the policy, due to the practical difficulties of fitting it into the neo-classical closed-end paradigm. This logic invites authorities to concentrate on the "failures" detected in market functions resulting from business conduct; official barriers are only considered when they increase entry barriers. The analysis seldom adopts a more all-embracing appraisal because it is assumed that businesses, rather than governments, are the cause of monopolistic behaviour in the marketplace.

Not surprisingly, conventional antitrust legislation is inadequate for addressing the kind of questions raised by the promotion of competition in an institutional way, aimed at ensuring the legitimate integrity of business expectations, which is essential for competition to blossom.

The powers of competition agencies to carry out such activities are limited to the mere formulation of recommendations and suggestions to law-making bodies, which can easily be turned down or disregarded. These activities do not amount to a full protection of economic rights to trade. For example, Article 24 of Mexico's *Ley Federal de Competencia Económica* states that the Commission may provide an "opinion" on the programmes and policies of other public agencies when their effects limit competition; or when requested to do so by the Federal Government. However, the same provision later adds, "the opinions will have no legal effect". Very often, competition advocacy is not

428 Khemani, The Role..., Sometimes, special considerations are made for developing countries. As Curiel argues: "Many times it has been said that antimonopoly policies may take two tracks: limiting co-ordination among existing competitors, and maintaining easy entry for new competitors. This might be true for advanced economies, but it is insufficient in economies in the midst of consolidating liberalisation processes. To economies in transition, it seems (instead) that certain existing residual regulations delay or prevent the entry of firms in certain sectors". (C. Curiel, Elementos para la aplicación de políticas de competencia en economías en transición. La Experiencia en Venezuela. Paper presented at the meeting "Políticas de Competencia en América Latina y el Caribe". Superintendencia Pro-Competencia-UNCTAD, Caracas, 23-24 October 1995, p.9.)

even considered in the respective statutes but has to be deduced from general legal principles and vague appeals to the "spirit of the law" in enacting a policy for the promotion of competition. This is the case of Venezuelan *Superintendencia Pro-Competencia*, whose advocacy powers rely on persuasion and institutional ascendancy rather than on legal powers. Furthermore, even where the statutes oblige law-making authorities to prevent restrictions on competition, their guidelines generally only apply to new regulations, or to rules enacted by administrative authorities, and are seldom applicable to legislation passed by Congress.

Despite these technical difficulties, competition advocacy has spontaneously flourished among competition agencies in the region, even in the absence of formal advocacy powers conferred by statute; this is however unlikely to continue into the future. Firstly, the interest in advocacy matters arises partly because, during the initial stages of implementing these policies in countries with no previous tradition, the newly appointed teams of antitrust officials are not engaged in intense prosecution activities due to their natural lack of experience in antitrust enforcement, and to their interest in providing businesses with a period of adaptation to the new rules. Hence, competition authorities can direct more resources into advocacy.

Secondly, advocacy activities are generally intense at the beginning due to the lack of effectiveness of policy enforcement in curbing perceived restrictions on competition. In the early days of the policy, courts often frequently turn down antitrust decisions either because they are unable to follow the structural logic behind them, or they see the matter as excessively technical.[429] Last, but not least, antitrust authorities tend to behave leniently towards enforcement activities in the first stages of implementing the policy because this ensures them a quota of *legitimacy* (or ascendancy) over business through

429 Jatar and Tineo argue: "[antitrust] cases, for the most part, end in the courts of justice, where the expertise to judge competition issues is limited. This brings the likelihood of rulings on a non-substantive basis and apart from the interest of the consumers" (Jatar and Tineo, p. 29). For this reason, they add somewhat puzzled: "Since [Venezuela's] Superintendencia Pro-Competencia's first decision back in 1994, almost all the decisions involving powerful firms have been appealed before the courts of justice. At present, 12 important cases are pending for judicial review. The first two decisions came out of the courts in 1997. Both overruled Superintendencia Pro-Competencia's decisions due to lack of legal standards." (p. 29)

the negotiation of a new status quo. Indeed, under the new legislation many types of conduct formerly praised or even encouraged by governments appear thereafter as illegal restrictions on competition. This encourages antitrust agencies to make compromises and reach consent agreements in place of adjudication. An example of this is found in the Colombian Superintendency of Industry and Commerce, which has focused its enforcement on reaching consent agreements, rather than on adjudication.[430] As a result, there is a tendency to rely on advocacy activities, which in addition provide competition agencies with an excellent opportunity to set their agenda for public opinion.

The elimination of legal barriers in Latin America is especially important. Practical considerations have prevailed over theoretical constructions, so although it is not easy to reconcile standard antitrust enforcement with the need to eliminate legal obstruction, Latin American antitrust agencies have spent considerable resources and time in advocating the elimination of legal rules which restrict competition. For example, between 1993 and 1995, Venezuela's *Superintendencia Pro-Competencia* devoted a significant share of its work to activities related to competition advocacy; more recently, this trend has tended to consolidate.[431] In addition, amongst the five most significant areas of policy action of Mexico's Commission (mergers, public bids, ex officio prosecutions, private disputes, and legal opinions) those pertaining to the use of "non-enforcement" powers clearly predominanted. Similar considerations apply in other jurisdictions.[432]

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430 O.A.S., Report on the Development and Enforcement of Competition Laws..., pp. 69-82. According to Jatar and Tineo "consent agreements have yielded a number of benefits in the Colombian transition process. They have minimized the impact that sanctions may have had in the economy. They have also provided the agency and firms with a mutual understanding of the laws and markets. This, in turn, has contributed to creating a competition culture among the participants as well as the conditions and expertise for a stricted enforcement of the law. So far, the Superintendency has reached consent agreements with powerful industries like cement, beer and health service providers. The agency has also dealt with abuse of dominant position of important state-owned companies such as railroads, oil, and energy. According to these settlements, the industries have pledged to stop the alleged anti-competitive practices, being warned that further violations of the agreements will be punished." (Jatar and Tineo, p. 13.)

431 Curiel, Elementos, p. 16.

432 A. Rodríguez and M. Williams, Economic Liberalization and Antitrust in Mexico, Revista de Análisis Económico, 1995 (Forthcoming).

It is unlikely, however, that limiting competition advocacy to preventive and corrective deregulation can provide the necessary predictability required for developing business activities in the long run. Firstly, this limitation leaves out many instances where it is not only desirable, but peremptory that governments eliminate obstacles to competition, by for example, providing a reliable system of dispute settlement. Secondly, it also distorts the real nature of competition promotion, which extends beyond the superficial task of persuading government agencies to follow competitive standards when enacting their own rules, but encompasses the full protection of individual economic rights by challenging any initiative aimed at creating privileges and monopolies through the "public interest" clause. Instead, competition advocacy demands much more commitment to clarifying social rules in order to make them predictable. The implications of this proposal are profound and go far beyond the limited realm of conventional powers of competition advocacy.

This section explores how competition advocacy could involve practical forms of policy action compatible with our particular concept of competition. In particular, we develop some initiatives here for the priorities which competition agencies should consider in their efforts to develop a more effective protection of market order.

Competition advocacy should take place in the setting of the "institutional" guidelines outlined in previous chapters. Following these standards, it seems more appropriate to define competition advocacy broadly. A committed policy for the promotion of competition in Latin America should focus on shifting the functions of Latin American government agencies towards improving the predictability of entitlements traded in the market, which in the last instance is what encourages entrepreneurs to compete.

Political authorities can foster several pro-active initiatives aimed at making the business environment clearer and more predictable; the goal is to create a favourable setting where managerial innovation, creativity and the emergence of valuable market information can develop in the form of improvements to knowledge, technologies and processes. In order to achieve this goal, it is necessary to eliminate all illegitimate sources of interference in the exercise of individual entitlements. The effective protection of these entitlements defines the extent of the activities of market participants and their use of social resources. Such an obligation would also extend to the transmission of rights related to entitlements by contract.

These obstacles could impose severe inefficiencies on society through the misallocation of social resources; and even more importantly through interference with the emergence of valuable new knowledge and information. Only by clearly defining the realm of individual appropriation of social resources and the conditions for the transfer of appropriated goods amongst market participants can businesses maintain tolerable expectations which encourage them to invest.

Effective "competition advocacy" could gain much institutional *transparency* by defining the real sphere of appropriation of social resources. But "appropriation" is not only the possibility of exercising effective control over a given resource in the present; it also encompasses the likelihood of future control.

Therefore, two conditions are required: firstly, a more effective definition of individual rights which tells firms the extent of their present access to social resources. Entrepreneurs must have reliable expectations about the conditions under which they can acquire property rights.

Secondly, a proper delimitation in the sphere of individual rights would not only embrace transparency, but also produce clear rules on the transmission of these rights in the future. In other words, entrepreneurs must also possess reliable expectations about future conditions under which they can trade their property rights under contractual arrangements. These conditions, namely a clearer definition of property and contractual rights, would enable entrepreneurs to form relationships in an "open" way, and thus be more adaptable to unforeseen changes.[433]

433 See in general, Epstein, "The Static Conception ...."

In addition, making such protection effective entails a clear statutory definition of property rights and the conditions for their transfer, as well as the assurance that any potential dispute about the interpretation of the extent to which parties are legitimate owners will be resolved through adequate settlement mechanisms. Thus, government intervention to protect dynamic competition and innovation should focus on protecting the content of individual spheres of action in cases where initial entitlement is challenged by insufficient transparency in the assignment, which has caused two or more entrepreneurs to hold legitimate expectations about the extent of their respective entitlements over a disputed social resource. An effective competition policy should implement efficient dispute settlement mechanisms, which allow the elimination of any source of interference and uncertainty in the initial allocation or transfer of rights. An efficient dispute settlement mechanism would solve *ex-post* conflicts over the use of resources resulting from poor identification and assignment of rights.

In this light, the goals of institutional competition policy are comprised of two basic initiatives: Firstly, in a negative sense, the competition authority should inhibit other government agencies from interfering with economic rights. This would require competition agencies to exercise technical and political accountability in relation to the interpretation of the "public interest" clause, which dominates almost every regulatory initiative in Latin America. "Official" institutions should then allow restrictions on trade only when special political considerations prevail, and are known by everyone. This could restrain governments from making a clarification or limitation of conditions, thus triggering the alibi of "public interest", which has always been an excuse for obstructive government.

Secondly, competition agencies should undertake positive initiatives to overcome the deficiencies of Latin American institutions in providing effective relief from the distortions of market expectations introduced by economic agents. These distortions occur, in part, because of the slowness of other government bodies in dealing with them. In this regard, "informal" institutions such as customs and social conventions must follow standards of "good faith" in the trading process. Governments should provide individuals with effective redress when the integrity of their rights is impaired by certain illegitimate business practices. Government intervention should ensure that market transactions are not adopted under conditions of violence, duress or fraud.

For this reason, it is necessary to ensure that individuals preserve their expectations about the identity of their trading partners and the products and services they trade in. This is the rationale for pursuing a policy against any conduct which is regarded as an "unfair" expression of competition, in the sense that it misleads market participants, and the public in general. This type of conduct comprises behaviour such as denigration of a competitor, false advertising, violating copyrights or trademarks, and so on.

Preserving legitimate market expectations also gives a rationale for improving dispute settlement mechanisms thus enabling individuals to clarify the extent of their entitlements in case of conflict.

We will now examine these areas of possible action more closely.

a) The amendment of official regulations affecting economic exchange through lobbying administrative agencies and the Cabinet.

i) Defining the political interpretation of the "public interest" clause.

Legal privileges and monopolies in Latin America have been granted by excluding or limiting individual economic rights in specified "strategic" sectors or "public interest" clauses within economic activities.

Naturally, the vagueness of this "public interest clause" encompasses a wide range of possibilities for government intervention which represent an effective exclusion of competition by private business.

Generally, the definition of public interest legislation which limits or excludes economic rights is made through legal statutes passed by Congress and covers many economic areas, and takes many forms.434 Very frequently, Latin American statutes dealing with the economy do not exclude individuals from certain economic sectors themselves, but subject their entry, permanence or exit to numerous conditions based on grounds of "public interest. Generally, these statutes follow the technique of leaving the administrative agency free to determine, either through more detailed regulations or on a case-by-case basis, how the activity might be undertaken without violating a condition of public interest.

Overall, regulations enforced in the shadow of the public interest clause range from conditioning business activity and ensuring certain requirements are met, to the outright exclusion of private competition in sectors deemed "strategic" and, as such, subject to nationalisation.

How does one define public interest? In principle, it seems reasonable to allow collective interest to predominate over individual interests. However, Parliaments often

434 These privileges relate to different areas of "public interest" regulation: 1) *Authorizations*, subjecting firms to government permission to undertake certain economic activities in a given sector, sometimes for renewable periods; 2) *Concessions*, whereby goverments subject the exercise of economic activities to specific conditions (time, geographical space, etc.). Concessions differ from general authorizations in that they are more specific about the way firms must behave in the market; 3) Special rules for *foreign investments*. These rules impose special exclusionary conditions on firms regarded as "foreign". Until recently, Latin American countries were prolific in raising barriers to foreign investments; however, most of these are gone today; 4) *Labour rules* regulate, in detail, competition in the labour market. Normally, collective bargaining is organized by legislative fiat, and therefore excluded from labour competition. These rules grant legal monopolies to trade unions in relation to labour relations: wages, social security, holidays, retirement, and so forth. Labour-intensive firms may find it impossible to innovate in such rigid labour environments; 5) *Health standards* require firms to follow standard procedures in the production of goods, particularly relating to public health. These standards frequently prevent innovation and entrepreneurship in the production of new drugs and products initially regarded as hazardous by overzealous regulatory agencies; 6) *Exchange regulations* subject firms' activities to a particularly harmful form of administrative discretion, namely, access to foreign currency. This barrier may be formidable to firms operating in foreign markets; 7) *Fiscal policies* that impose discriminatory taxation on firms; 8) *Trade policy* that discriminates against foreign competition. Particularly disturbing in this field are rules that clearly do not meet informational standards such as antidumping and countervailing policies; 9) *Credit Policy*. The provision of preferential credit on certain firms inhibits competition by firms not favoured. This is frequent in the agricultural sector; 10) *Price Policy*. Competition is inhibited if governments impose price controls. There is ample experience of this in Latin America, where some sectors deemed "essential", are still subject to price controls; 11) *Privatization*. If the conditions under which privatization is undertaken favour specific groups, then competition may be unfairly distorted.

redistribute wealth across society by using legal statutes to convey these "social orders"; to do so, they must grant privileges which conflict with market order and the promotion of competition.

The desirability of such redistributions is a political matter on which competition policy can have little influence. In any case, the law-making authority must clearly identify who would benefit, as Rizzo has noted.[435]

This is an important point. The crucial element is to determine *whether the government possesses sufficient information to develop welfare systems in favour of special groups identified as disabled or in need.*[436] Like economic markets, whose functioning depends on the information available to all participants, political markets also work better when there are mechanisms to display information about the relative value of the needs of all participants.

Of course, the requisition of more information about the winners and losers of certain policies from those who draft legal rules in Parliament may be a formidable task, but it would increase their political accountability to their constituencies. For political reasons, there could be a periodic review of the desirability of these legal rules according to changing circumstances. This would determine, for example, whether some sectors should no longer be considered as "strategic", thus allowing private firms to compete on an equal footing in the market. It would also provide political grounds for supporting the privatisation of nationalised industries, or deregulating certain activities.

This is a task which competition agencies could perform by advising law-making bodies, and even appealing to public opinion when required. For instance, in Venezuela, one of the recent activities of *Superintendencia Pro-Competencia* has been to develop public policy reports. These reports contain the bare essentials of policy measures that

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435 M. Rizzo, "Rules versus Cost-Benefit Analysis...", pp. 865-884.

436 D. Anderson, How can we Discharge our Obligations to the Poor?, in "Religion and Public Life", D. Cohnsherbok and D. McLellan (eds.), St. Martin's Press, New York, 1992, pp. 98-109

need to be implemented in specific sectors to promote competition and equity. Studies have been conducted in the agriculture, telecommunications, electricity, transportation, education and other sectors.

Competition laws could provide agencies with effective powers for this task and even modify the formal institutional framework of market exchanges by eliminating rules that create legal monopolies and privileges.

Sometimes the power to deregulate is found in existing Latin American antitrust statutes; but as we have already stated, these powers are very limited and restricted to the formulation of mere recommendations to other executive agencies. However, most recent Latin American antitrust statutes attempt to extend these powers; for example, Costa Rica's *Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor* establishes a detailed regime of deregulation and competition advocacy. Article 3 sets forth guidelines for government agencies on the control and regulation of the economy. This provision also applies to existing regulations. However, these guidelines cannot overrule restrictions on competition and freedom of trade imposed under "special statutes", "international agreements", and in general provisions required to preserve health, national security, the environment, or standard procedures.

Similar considerations apply to Article 4, which enables the Comisión to make a cost-benefit analysis of regulations restricting competition. It is difficult to see how the Comisión can comply with this mandate, given the impossibility of appraising the social cost-benefit referred to above. In addition, despite the apparently broad powers of the Comisión to make the analysis and challenge legal rules which conflict with the formula, the power to remove the obstacles ultimately remains with the Cabinet.

Articles 5 and 6 set forth the conditions on which the Cabinet may eliminate price controls, or other restrictions on trade. These provisions are supplemented in Article 7 which establishes the conditions for the provision of services related to trade, and Article 8, which establishes the conditions for the functioning of standard-setting bodies. All these provisions either confirm the general conditions set forth in Articles 3 and 4 in particular areas, or supplement the system by laying down specific requirements.

ii) Giving competition agencies powers to undertake competition advocacy activities.

These powers are still too limited to allow a successful deregulation process, because the ultimate source of power to eliminate restrictions on trade lies with the legislative branch, and not the competition agency.

Hence, political obstacles to competition ultimately spring from the limitations on accountability resulting from the constitutional division of powers, and the functions developed by each branch of government. Most Latin American antitrust agencies are administrative bodies that lack the formal legal powers needed to repeal restrictive rulings, regulations or decisions made by other authorities in the public administration or executive branches. At best, they may offer advice about the effects on competition of the adoption of legal rules at other government levels.

Most of their competition advocacy activity is spent in arduous negotiations with other governmental agencies, which are ultimately fruitless (as these agencies normally pursue interests that do not involve preserving competition). Competition agencies are not even granted legal standing to challenge these decisions in the courts as an Ombudsman of economic rights. They must therefore resort to lobbying the Cabinet, with little chance of success.

Although these provisions are limited, they do have the virtue of focusing on the need to control government acts which generate restrictions on competition; for example, Article 3 of Costa Rican Law entrusts the *Comisión* with powers to oversee the ex-post effects of regulations on economic activity and evaluate the justification for those restrictions on competition based on health, environment, security and quality.

From these provisions stems a clearer conceptualisation of the problem of promoting competition in developing countries, which is not based solely on challenging the restrictive activities of firms, but also on subjecting Government activity to technical supervision and political accountability. In the light of Latin American traditional support for restrictive trade measures, the Costa Rican competition advocacy provisions are a clear step forward, and are a very welcome legislative initiative. Another example is Panamanian Ley No. 29, 1996, (Articles 238 through 241).

b) Reforming informal institutions by eliminating illegitimate business obstacles to trade (unfair competition).

A second area of policy which promotes competition deals with business practices that erode the effective use of legitimate entitlements by other market participants.

As stated earlier, the rationale for authorising restrictive business behaviour is that it allows intervening parties to enhance their future expectations. This rationale justifies the condemnation and prosecution of business activities aimed at erasing such expectations, in the hope of engaging in rent-seeking activity at the expense of the victim's rights. The possibility that property rights are poorly drafted due to the inherent difficulty in assigning them individually allows rent-seekers to appropriate them. The effect of such conduct diminishes the expectation that market participants have of reaping the full rewards of their investments.

It is therefore essential to guide and constrain informal, unofficial institutions emerging from social interaction, in order to preserve the transparency of business conduct and "good faith" as the basis of business transactions.

The legal system may have difficulty in identifying the private property rights over certain goods whose nature it is difficult to define, but the decision to invest resources is no less crucial. Commercial reputation and good will are classic examples, but not the only ones. There are clear problems in defining effective ways to prevent these assets from being misappropriated by illegitimate third parties.

This problem is at the heart of commercial transactions which custom, tradition, and general trading experience have come to regard as "unfair" business practices. They erode transparency in the allocation of property rights, thus inviting illegitimate third parties to misappropriate them. Clearly, it is not easy to identify them, because the collective understanding of the sense of "unfairness" may change over time, and technological progress may improve the identification and private assignment of formerly public goods. For these reasons, the classification of acts of unfair competition is prudently broad, enabling their interpretation to be made on a case by case basis.[437]

Breadth, however, is not necessarily a synonym for "vagueness". Market institutions are built on the fact that individuals are able to rely on them in their trading exchanges. Trade is fundamentally possible because of a favourable institutional framework, which is based, as we have seen, on positive mutual expectations about the ability to achieve individual goals in the future. Market participants have a subjective perception of these expectations and goals, which are in a constant process of redefinition.

Combating unfair trade practices means endowing competition agencies with the capacity to effectively prosecute trespassers and adjudicate rights efficiently. The existing bodies and tribunals are poorly suited for this task, particularly in the weak Latin American context.[438]

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437 The classification attempted by legal scholars is somewhat arbitrary as it does not follow a clear pattern. Nevertheless, they generally relate the "unfairness" in trade to the confusion created about the identity of firm, the nature of the product traded, the nature of the service, the reputation of the trading firm, and in general, the "subjective" bond linking the perception of consumers to the quality and reliability of a given firm. The literature about "unfair competition" is vast, and we cannot deal extensively with the subject here. More extensive studies are found in Allart, Traité de la concurrence deloyale, París, 1892; U. Navarrini, Trattato teórico-pratico di Diritto Commerciale, Istituto Ed. Scientifico, Milano, 1931 and T. González, La Competencia Desleal, Universidad Central de Venezuela, Forum Editores, Caracas, 1992. Finally, A. Coriat, La Competencia Desleal en la Propiedad Industrial, in "Propiedad Intelectual y Desarrollo Tecnológico", Monte Avila Editores, 1992, pp. 109-122.

438 In the context of institutional reform, particular attention has been paid to the important role of the judiciary in effectively sustaining the reforms. Reforming the judiciary covers a broad area ranging from the question of independence from other branches of government to legal education. It is far too complex a subject to be dealt with here. See in general, M. Dakolias, The Judicial Sector in Latin America and the Caribbean, World Bank Technical Paper No 319

c) Should antitrust enforcement exist?

These considerations suggest that the scope of present antitrust activities would have to be reduced significantly under the institutional framework proposed for the promotion of dynamic competition. But should that mean outright elimination?

However, these considerations do not question the practical use that some antitrust principles could have as a deterrent for certain illegitimate market restrictions engaged in by businesses that enjoy indirect form of "official" or "quasi-official" protection from open competition. This is frequently the case in the telecommunications, railroads, iron ore, and other "strategic industries", and similar privatised sectors. In these cases, privatised firms sometimes hold some form of legal protection from open competition under transitional arrangements. Similarly, business trade associations attempt to maintain established trade practices, implemented in the context of former development policies which granted them quasi-legal status. These provisions frequently have a similar effect to regulations, since they encourage the cartelisation of members, as regulations did in the past. Certain basic antitrust provisions like price-fixing prohibitions could act as a deterrent to these conducts.

In these cases, the effect of legal rules (or quasi-legal rules) is to "close" the open-ended nature of market interaction. Consider the rules enacted by trade associations to subject their members to "codes of conduct" or "ethical standards". Generally, these arrangements conceal price fixing, market allocations and similar practices which are binding on members who suffer retaliation if they act independently. Industrial and trade associations in the region frequently emerged as organised lobbies pleading for protection from competition through official prices and similar restrictions. It is not surprising that today they tend to resort to these anticompetitive practices as a way of resuming their former lobbying activities, albeit without official consent.

(Washington, DC: The World Bank, 1996). Also, M. Rowat, W.H. Malik and M. Dakolias (Eds.), Judicial Reform in Latin America and the Caribbean: Proceedings of a World Bank Conference, World Bank Technical Paper No 280 (Washington, DC: The World Bank, 1995.)

By effectively enforcing these self-imposed regulations, economic agents behave as if the open-ended conditions of market interaction were subject to narrower bounds. For example, decisions taken by the board of a business trading association could have a similar effect to that of a law enacted by Congress, in the sense that new competitors are effectively restricted from entry.

These practices reduce the flexibility needed to adapt to unforeseen circumstances by curbing the capacity of cartel members to act freely. Firms will not attempt to exploit new opportunities, simply because opportunities will not arise. Instead, they will concentrate on obtaining captive rents from other individuals by obliging them to accept a forced transfer of resources performed by the legal regulation, or quasi-legal measure. In these cases antitrust measures could provide some "compensatory relief" for those adversely affected by these forced transfers of wealth.

It might be useful to grant some powers to administrative bodies, such as competition agencies, to challenge these agreements, since lobbying law-making bodies could take significant time and effort, and courts in Latin America are clearly inefficient.

Such provisions, however, should be exceptional. That is, they should be used only when a legal restriction is found to be directly linked to a business restriction. Relying on legal evidence in this regard (i.e. the existence of a trade association agreement) could bring a much required clarity to the analysis. A legal approach would also restrain unchecked discretion by determining the "proper" economic conditions for establishing the monopolistic intention of restrictions undertaken by firms acting under the conventional analysis of antitrust policy. For this reason, enforcing antitrust policy in these cases is only second best to deregulation, because it would be subject to all the above-mentioned caveats.

Rather than challenging our general premise that antitrust should focus on specific instances where clear legal or quasi legal rules prevent market actors from behaving freely, these cases reinforce the idea that linking the legality of business arrangements to the analysis of structural economic market conditions, as antitrust regulations do at present, would inevitably have undesired effects on the institutional framework.

4.- INSTITUTIONAL STRUCTURE FOR THE PROMOTION OF COMPETITION.

4.1.- Institutional features necessary for successful competition advocacy.

Kelly highlights the inherent difficulties of the agent-principal relationship between regulatory agencies and governments in the implementation of successful regulation.[439] Competition agencies are no exception in this case. Indeed, the depth and breadth of the responsibilities entrusted to competition agencies clearly illustrates the challenges of enforcing competition advocacy. Successful competition advocacy requires certain institutional features unlikely to be found anywhere within the three branches of power. On the one hand, it is necessary to ensure that competition agencies enjoy sufficient credibility to regulate markets, which may require that they be bound to transparent rules. On the other hand, competition agencies should have enough flexibility to ensure that their regulations adapt to changing circumstances. To achieve these goals, three conditions have to be fulfilled:

Firstly, an important degree of technical expertise and flexibility must lie in the hands of regulatory agencies. This is important in order to identify and assess the problems brought to their attention, and strike a balance between all interests committed to the formulation of alternative public policy solutions.

Secondly, an important degree of effective independence and political isolation from the pressures of government, is necessary to enhance their credibility as impartial regulators before society.

439 J. Kelly, Cómo crear instituciones regulatorias autónomas sin morir en el intento, paper presented at the seminar "Instituciones, Regulación y la Nueva Economía", 14 October 1998, IESA, Caracas.

Finally, it must have political clout and effectiveness in implementing policy recommendations.

a) Adequate technical expertise for balancing competing interests.

The regulatory structure must be capable of balancing competing interests that affect market access. The convenience of setting protective measures such as tariffs, non-tariff barriers, regulations and price controls has to be examined in the light of competing interests within society. The opinion of those that favour deregulation and the elimination of these obstacles should also be taken into account. To strike this balance impartially, technical expertise is essential.

There are several ways to ensure a minimum level of technical expertise amongst competition officials: high salaries; special standards in the selection of personnel; accountability of decisions adopted by an independent internal or external body, to name a few.

Other initiatives may comprise the structure of the agency itself. For instance, collegiate decision-making bodies are preferable to single-person bodies, because decisions taken are appraised by more people.

Finally, technical expertise may be used in different ways. Sharing information concerning the making of a particular guideline or rule could be important. This could be done by incorporating the technical views of those affected by the rule. In some countries, the technique of advancing "guidelines" through "white papers" is useful for framing rules agreed by both regulators and regulated firms.

b) Effective independence from political interference.

Credibility also requires competition agencies to be perceived as independent decision-makers, isolated from the political interference exercised, most often, by governments. Independence may not be effective if there is some degree of control by an "outsider"; either an official body, or groups from the private sector.

The independence required for the administrative activity of competition agencies is dual: firstly, financial independence needs to be obtained by funding from a variety of sources, including private-sector or non-governmental organisations. Most Latin American agencies are tied to the general state budget, hence, they have limited independence with respect to hiring specialised personnel, and developing programmes of training and education in the goals of competition in market economies.

Secondly, competition agencies require functional independence to allow them follow whatever course of action they consider necessary to promote competition without external interference. Because of the technical nature of their decisions they should not be subject to political review by the minister of the area, the Cabinet, etc; thus, appeals should be limited to judicial review. In this context, the transparency of the decision-making process may play an important role, for which consultations before bringing trial cases, or enforcing a rule may be useful. Latin American experience in this area is generally similar: most countries allow administrative review by the enforcement agencies themselves, which are seldom subject to outside administrative control.

Independence is also strengthened by other means, such as stability in the appointment of officials, transparent procedures and more informal arrangements, including the seeking of alliances with strategic sectors in society (i.e. consumer associations), which may provide an important base from which competition agencies can act independently of political directives.

Finally, independence from the influence of regulated firms should also be preserved. Rules to prohibit officials from working for investigated companies after leaving the agency could be an important disincentive in this regard.

c) Effective powers of advocacy.

Lack of political interference should not be confused with "isolating" competition agencies from society. On the contrary, one essential condition for their success in promoting competition is that they are endowed with effective powers to be able to undertake advocacy activities in favour of competition.

This entails legal powers to bring cases before the courts that cannot be decided internally, because they involve the activities of other government agencies. It may be necessary to vest competition agencies with the power to act as public prosecutors in order to identify and challenge such interference before the courts.

4.2.- Bodies responsible for enforcing institutional competition policy.

The conditions necessary for successful competition policy could be implemented by setting up two separate agencies to develop these activities: an administrative tribunal, and a Public Ombudsman, differentiated as follows:

a) Administrative tribunal for the promotion of competition.

Firstly, it could be convenient to set up a specialised administrative tribunal designed to subject markets to public scrutiny and control. Such a tribunal would be comprehensive in nature. It would supervise the conditions under which individuals have access to markets; for example, by reviewing and authorising intellectual property rights (trademarks, patents, etc).

The abusive exercise of these rights could affect the entry of potential competitors; therefore, their proper delimitation would improve the transparency of the legal system, as it would define the identity of market traders and their products. This is an essential condition for improving the predictions of economic actors, because it allows them to clearly define the scope of their business reputation which, as we have stated above, is a way of developing informal institutions among market agents.

These added powers would provide the competition tribunal with sufficient financial support from applicants for patents, copyrights and trademarks to provide the agency with much-needed financial independence from the state.

The tribunal would also have jurisdiction over business practices which erodes the transparency of property rights assigned to victim firms. This would include the whole array of conducts deemed to be "unfair competition" which are exercised against a competitor: product simulation, fraudulent imitation, erosion of the reputation of a competitor by illegitimate means, and others identified above. It would also include the whole array of conducts that adversely affect the rights of consumers, and erode the transparency of market transactions; for instance, refusal to comply with contractual conditions agreed at the time of sale, such as guarantee clauses, servicing or maintenance of products. It would also cover cases of misleading advertising, which erodes the reputation or properties of products sold by competitors.

An administrative tribunal would also be entrusted with powers to encourage deregulation from within the executive branch in order to facilitate entry and exit from the market.

Such a tribunal would ensure the proper combination of independence, promptness and prudence in the decision-making process. It would also have several advantages over other forms of institutional arrangements. Firstly, it would be independent of the Cabinet, while remaining within the executive branch of government. Secondly, it would possess broad powers to request information from market participants, and enforce its decisions Thirdly, it would be a collegiate body, making its decisions more balanced. Fourthly, a tribunal could appoint its own personnel (essentially attorneys and economists) and function effectively with a relatively small staff. Fifthly, it would enjoy budgetary independence, as well as funding from other sources. Finally, as a tribunal, it would be much more sensitive to the problem of eliminating legal rules that distort economic activity.

b) Public Ombudsman for the protection of economic rights.

It may seem obvious that courts should be effective in controlling and preventing possible encroachments on individuals; yet in the case of Latin America, this is a relevant issue, given the poor performance of the judicial systems in delivering effective and prompt justice.[440] For this reason, it is important to create a public agency to act on behalf of the victim, and as a guarantor of the public interest to protect property rights and make them as effective as possible.

An appropriate figure would be a combination of public prosecutor and ombudsman, whose activities protect individual economic rights which may be impaired due to the effect of legal rules or, more specifically, government intervention based on such rules. This agency would also encourage deregulation from outside the executive branch; for example, by challenging legislation restricting competition in the judicial courts.

The Ombudsman would act as a third party interested in the protection of competition, joining private individual actions against government encroachment on economic rights in both the executive and legislative branches. In some jurisdictions the role of the "ombudsman" is to join claims made by private individuals against government encroachment on their rights.

This task requires extensive powers (by action or injunction) to restrain legal rules that obstruct competition once competition agencies have determined their restrictive effect on market transactions. Competition agencies would have to adopt the form of tribunals vested with judicial powers, including the power to review the substantive content of any administrative act that challenges *institutional* efficiency, and which is not justified on strictly redistributive grounds.

440 The low levels of performance of the judicial sector in Latin America have been emphasised recently by Buscaglia and Ulen: see Buscaglia and Ulen, Op cit. The importance of judicial reform in reforming economies has been stressed by several authors. See M. A. Dakolias, "Strategy for Judicial Reform: The Experience in Latin America", 36 Virginia Journal of International Law, [1995], 167-231.

5.- CONCLUSION: AN ALTERNATIVE VIEW OF REGULATION IN THE PROMOTION OF ECONOMIC DEVELOPMENT IN LATIN AMERICA.

The idea that the only way governments can effectively shape markets and promote competition is by intervening has to be dispelled.

In our institutional proposal, competition policy would involve a proactive public policy by government; it would not imply a do-nothing attitude in the face of restrictions and distortions that affect competition. It would differ from the failed interventionist policies of the past that attempted to control market transactions. And it would be very different from the antitrust enforcement used today to promote competition. Its proactive character would require public agencies to take particular care in defining and enforcing clear guidelines and standards so as to enhance the expectations of all market agents. It would therefore pay comparatively little attention to the relative size of firms within the market; instead, it would emphasise a transparent legal setting that preserves the legitimate expectations of all, *regardless of their relative size*.

This proposal acknowledges the need for governments to adopt a proactive attitude to challenge the entrenched rules and institutions that hinder competition in Latin America. Deregulation and trade liberalisation are not sufficient alone to achieve these ends. The promotion of competition must also encompass other initiatives.

However, to identify these policy initiatives, the substantive principles guiding policy action have to be defined. Under our institutional framework, public policy would enhance the opportunities for individuals to gain access to useful information, even if in so doing output is temporarily restricted and potential competitors are excluded from the market.

The conventional assumption that output restriction always operates against consumers is refuted by considering the costs that voluntary agreements save for the parties involved, in obtaining information they would otherwise have had to seek in the market. Even neo-classical scholars increasingly acknowledge this, by progressively discovering new justifications for allowing restrictive arrangements among market participants. For example, the exclusion of competitors is no longer seen as an evil in itself.

It is essential that the efforts of firms committed to making investments are rewarded in the marketplace, particularly in their development of "public" and "private" goods that lack a clear assignment of rights. An example of this is the development and spread of information into the market system. To do this, public policy should allow individuals to make arrangements aimed at eliminating the opportunism of potential free riders and exclude them from appropriating "public goods". It should also let individuals punish any attempts by their contractual parties to reduce their legitimate expectations: this is an essential condition for reducing the natural uncertainty of the market.

As these examples show, the entitlements that institutions provide are effective because of the assurances they give to those who hold them, not because governments formally declare their existence and establish mechanisms of redress (formal institutions). Individuals may develop ways of attributing parallel effectiveness to such entitlements (informal institutions). However, governments can enhance or undermine the "substantial" efficiency of formal entitlements. Antitrust policy is merely one case where governments reduce the expectations of individuals with regard to the real extent and effectiveness of their entitlements.

For these reasons, public policy should attempt to reinforce those links and mechanisms that firms use to reduce their uncertainty. This is not a matter of merely publicising the regulations. It also means adapting public policies to rules with true social legitimacy, which are not necessarily formally binding, but which are those rules recognised as such by society.

Given the obvious practical problems in identifying these rules, the most reasonable course of action is to allow individuals to determine them by their own experience, and to achieve their goals through the mechanisms at hand. Public policy should merely define which individuals can trade; (that is, assign property rights) and clearly determine the rules governing such trade, so as to reduce the uncertainty for all parties involved. These rules should prevent individuals from taking a free-ride on the efforts of others, and obtaining an undeserved value for their exchanges (for example, fraud). Understood in this way, free-riding is not a phenomenon attributed to distribution contracts, but one phenomenon which affects all social life. Instead of regulating free riding and similar behaviour, public policy can clearly assign property rights, whilst allowing individuals to arrange them so as to prevent these practices.

This is why our approach to promoting competition focuses on the idea of reducing (or at least not enhancing) the costs of uncertainty for those making transactions within the market. For this reason, we criticise antitrust policy insofar as it enhances such costs through unchecked administrative discretion.

The economic costs of the legal framework are extremely difficult to measure, since they depend on countless variables. They are related to the expectations that individuals have of the circumstances surrounding their future, which is a subjective variable whose effects are impossible to quantify through empirical analysis. This is why we have developed general approximations showing the possible effects of uncertainty brought about by antitrust regulation.

Although certainty appears to be a poor indicator of how much intervention is desirable, it clearly shows the direction in which public policies should progress in order to enhance wealth. In other words, it is useful to establish the quality of state intervention, which is the central concern of this work. Scholars are now developing this answer, leaving aside the discussion of *quantitative* intervention. (Which practices should be regarded as anti-competitive? How should we improve enforcement? etc.). They are now focusing on the institutional incentives that are needed to promote development. In terms of competition policy, this new approach implies that we are dealing with the *kind* of public policy that needs to be implemented to enhance competition.

These new policy standards should recognise that contracts are instruments negotiated to enhance the smooth running of market relationships. They are basically intended to reduce uncertainty; or in other words, to enable individuals to gain knowledge about their environment, and consequently help them discover new opportunities. While allowing individuals to co-operate, contracts are legal instruments designed to enable them to compete.

Therefore, a normative goal for public policy which is adapted to real markets is that it should enhance the predictability of market relationships. Above all, competition policy must enhance predictability among individuals; it should not prohibit agreements entered into by parties to enhance their future expectations. Nor should it entail unwarranted discretion, which diminishes the predictability that individuals have over their own property rights.

In Latin America, any attempt to identify an appropriate policy to promote competition has to acknowledge the need for reform of the institutional framework. Guided by the substantive principles outlined above, such a reform would have to tackle the limitations of both formal and informal rules in encouraging competition. Firstly, the suffocating presence of the state in every area of business activity could be reduced by extensive deregulation and further liberalisation of trade. So far, the results in this regard have been satisfactory. Secondly, the informal rules embodied in conventions, practices, traditions, customs and the like, which at present represent an obstacle to freedom of trade, could be challenged by the effective protection of individual rights. This protection would incorporate "unfair competition", which can be understood as any attempt to erode a person's rights to trade by undermining the certainty of the legitimate owner's entitlement to them. This could be accomplished by a more effective judiciary, by diversifying mechanisms for dispute settlement, and by preventing disputes through more effective property registries.

CHAPTER V. CONCLUSION: THE CHALLENGE OF CREATING PRO-MARKET REGULATIONS IN LATIN AMERICA.

"The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process."

(J. Schumpeter, Capitalism, Socialism and Democracy, p. 82.)

"The fascination with Pareto optimality and perfect competition is a major obstacle to understanding economic development."

(B. Loasby, Equilibrium and Evolution, p. 25)

1.- LATIN AMERICA'S INSTITUTIONAL TENDENCY TO PERPETUATE OLD SUBSTANCE THROUGH NEW FORMS: THE CASE OF ANTITRUST POLICY.

The ultimate goals of institutional reform in Latin America are entrepreneurial creativity, innovation and economic growth. Consequently, policy-making activity should be judged by how effective it is in fostering these goals.

However, the goals of antitrust policy seem to be linked to a particular form of resource allocation which may run counter to these objectives. Regardless of whether such an allocation pursues Pareto efficiency and perfect competition, or other goals such as the protection of small firms, or the preservation of political values regarded as socially valuable, it entails a departure from the spontaneous market outcomes that would occur without interference.

Indeed, antitrust policy is essentially not much different from the other policies that have characterised government intervention in the region in the past, which in the name of promoting economic growth led to market restrictions and economic privileges at every step. Compared to these, of course, antitrust presents itself as a policy which perhaps possesses a normative appraisal of policy-making based on a conventionally accepted theoretical framework. However, its does in fact produce similar results.

These practical results should come as no surprise. Regarding markets as *imperfect* structures or states of affairs, incapable of reaching an ideal normative standard, defines a special mind-set or logic in policy-making that always leads to the same conclusion, regardless of the particular social welfare standard sought, namely, that government regulation *purposive* could improve market outcomes. Such an appraisal of regulation, based on a misleading closed-end perception of market phenomena and a utopical view of regulation, is ultimately responsible for leading many earnest advocates of economic development in the region, both before and after *apertura*, to propose measures inconsistent with market development.

Parallels can be drawn between the views of those who view purposive intervention as a means of "improving" markets and those who view it as a means for replacing them with government fiat in the opinion of one of the staunchest advocates of socialism in this century, Oskar Lange. He contended that "the possibility of determining the distribution of incomes so as to maximise social welfare and of taking *all* the alternatives into the economic account makes a socialist economy, from the economist's point of view, superior to a competitive regime with private ownership of the means of production and with private enterprise, but especially superior to a competitive capitalist economy where a large part of the participants in the economic system are deprived of any property of productive resources other than labour. However, the actual capitalist system is not one of perfect competition; it is one where oligopoly and monopolistic competition prevail. This adds a much more powerful argument to the economic case for socialism. The wastes of monopolistic competition have received so much attention in recent theoretical literature that there is no need to repeat the argument here. The capitalist system is far removed from the model of a competitive economy as elaborated by economic theory. And even if it conformed to it, it would be, as we have seen, far from maximizing social welfare. *Only a socialist economy can fully satisfy the claim made by many economists with regard to the achievement of free competition.*" (Author's italics)441

441 O. Lange, On the Economic Theory of Socialism (New York: Mc Graw-Hill, 1964), pp. 106-107. Of course, Lange assumed that in operational terms such a goal could only be achieved by nationalising production and giving the respective orders to public officials in charge of running state-owned enterprises in order to achieve free competition. In the absence of extreme government intervention, there is no question that he would have seen in antitrust policy a perfectly logical device to achieve the socialist allocative goals he advocated, by prosecuting firms unwilling or incapable of behaving as *social welfare* dictates. Clearly, from the policy viewpoint the underlying logic in both cases is similar: governments must intervene in order to achieve the optimal resource allocation impeded by market failures such as those arising from

For this reason, it is necessary to appraise the logic of antitrust policy more closely before endorsing the contention of so many Latin American scholars that it is capable of pulling the region out of interventionism, thereby creating capitalist habits. This is not necessarily the case, as empirical evidence shows.[442] Advocates of antitrust policy may have a misconception about the particular nature of markets and the role of entrepreneurs which could distort and possibly delay genuine initiatives aimed at introducing new markets in Latin America.

There is a clear risk that antitrust enforcement could reintroduce former government interventionist policies, albeit in a disguised fashion. In this respect, Rajapatirana provides us with an interesting study on the effects of trade liberalisation policy in several Latin American countries. She shows how the effectiveness of these policies has been limited by the reintroduction of many trade restrictions under new forms and disguises.[443]

This is not to say that competition policy is unnecessary, or indeed, harmful. Rather, it suggests that the promotion of competition and entrepreneurship in Latin America deserves wholesale reconsideration from the very outset. Governments may adopt active policies for the promotion of competition; indeed, they ought to do so.

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monopolistic competition.

442 See in general, F. McChesney and W. Shughart (eds.), The Causes and Consequences of Antitrust: The Public-Choice Perspective, The University of Chicago Press, Chicago, 1995.

443 The study referred to here, conducted in Argentina, Chile, Colombia, Jamaica, Uruguay and Trinidad gives an explanation based on the approach of the School of Public Choice for the reasons that led these countries to slow down the pace of trade reform in different areas and levels of economic activity. The conclusions highlight the real problems that the promotion of competition faces in the region. In particular, Rajapatirana argues that "despite trade liberalizations, some sectors have continued to receive protection [and] *there have been attempts to introduce measures to provide relief to activities which have been subject to increased competition from imports, on the ground of [unfair] trade practices*". Although the study explains the Latin American rent-seeking behaviour in the field of international trade, its conclusions can be easily extended beyond, into trade in general. See, S. Rajapatirana, Post Trade Liberalization and Institutional Challenges in Latin America and the Caribbean, internal paper, Finance and Private Sector Development Department, World Bank, Washington, DC 1995, pp. 19-20.

However, the basis of these policies has little to do with antitrust enforcement, whose principles may subvert rather than promote competition.

It seems that the fundamentals of antitrust policy are oriented towards restating old government customs of rearranging market outcomes, condemning certain market prices on considerations of fairness, and judging whether certain levels of output are "socially convenient" (i.e. optimally efficient).

There is no question that measures to control mergers, challenge market arrangements that directly or indirectly set "excessive", "monopolistic" or "unfair" prices and prosecute unpopular dominant firms are closer to the old-style closed-end regulatory policies practised in the region, than to the markets.

Rather than opening up spaces for enterpreneurs to display their talent and creativity, the investigative activity of antitrust agencies concentrates on measuring markets; determining the *right* levels of market concentration; establishing the proper degree of "contestability" in suspected industries; counting the *appropriate* number of firms; measuring the *right* size of the relevant market; and similar structural endeavours. They simply dismiss the analysis of entrepreneurship, innovation and economic growth that competition processes spur (which are crucial for developing countries to understand and exploit), and the arrangements that make them possible.

In fact, antitrust scholars would regard many of these arrangements as incontestable empirical evidence of businesses' intentions to manipulate markets in favour of monopolistic conduct. For example, Jatar and Rodríguez argue that "the problems (justifying antitrust intervention) arise from acknowledging that the principles embodied in free and open markets are novel and run counter to established business practices, institutions and traditions (...). The historical feedback between governments and private sector (...) is adopted within a setting in which the small number of individuals deciding on political and economic matters are acquaintances, friends and have deep [personal] relationships, often strengthened by family links (...). These traditions (...) may support the creation of anti-competitive alliances".[444]

Not surprisingly, guided by this advice, Latin American antitrust enforcement has begun to challenge many efficient arrangements and market undertakings on the basis of their alleged restrictive effects. As we have insisted in this work, antitrust policy has been dominated by a conventional paradigm that regards these restrictions as manifestations of attempts at monopoly. An alternative appraisal would judge these as an efficient means of conveying information to all entrepreneurs by limiting the array of possible courses of action that would accrue if they could undertake alternative investment initiatives. In fact, they allow all concerned to maintain their expectations about the conduct to be expected from everyone else.

By adopting the simplistic view that competitiveness in markets is dependent on the closeness of their resemblance to the "perfect competition" model (or a substitute one, such as "workable competition"), antitrust theory cannot satisfactorily explain, beyond the market-monopolization argument, how it is possible for firms to co-operate. Instead, it draws ex-ante standards defining the "social costs" allegedly imposed by certain corporate and other less stable forms of co-operation, which eludes the problem of why co-operation occurs at all. It calls for a moralistic judgment based on the idea of market "failure".

Antitrust enforcers employ ready-made assumptions which link certain levels of concentration to anti-competitive results: single firms in the market produce less at higher prices; fewer firms in the market will be prone to engage in oligopolistic behaviour; the acquisition of competitors occurs because a firm wishes to gain market power against competitors and consumers.

444 A. Jatar and A. E. Rodríguez, Elementos de una política de competencia para Honduras. Informe preparado para Management Systems International, Washington, DC, September 1995, p. 18.

Ultimately, the lack of clarity in the adopted regulation is linked to a particular understanding of the world, which misconstrues the arrangements entered into by entrepreneurs in order to solve their lack of certainty about the institutional environment where they must invest. Therefore, a wholesale reappraisal of markets and regulation, which conventional epistemology is unable to deliver, may be necessary before endorsing the optimism of regulatory reform in Latin America.

By comparing contradictory paradigms for an understanding of market interaction and competition, this work has aimed to show how scientific truth in the realm of social science is relative to those values and perceptions of the world. Therefore, the paradigms which compete for an appraisal of social interaction and which are based on different methods of scientific inquiry lead to different views concerning public policy, individual rights and public law.

This work has shown how our perceptions of social phenomena, market interaction, and desirable regulation are closely related to this particular understanding of social science. Linking the analysis of social reality to a particular vision or "paradigm" is useful because it dispels the assumption, shared by many scholars in this field, that this policy is the expression of final and objective truth about the behaviour of firms and markets. Such recognition highlights the operative limitations of the policy in achieving its proposed goals.

Logical positivism obscured this important caveat, because it lured scholars into the mirage of hoping to discover an impossible "objective" truth in social science. It was concerned with developing a value-free science, which implicitly presented scholars with a false dilemma, namely, that of choosing between applying the objective methods of natural sciences or relinquishing all endeavours to make social science objective.

The possibility of objectivity in social inquiry daunted scholars and made them prone to believe that economic analysis could deliver a faithful and reliable picture of markets through which corrective measures could be devised in case of malfunction. Unfortunately, this is a premise based on weak epistemological grounds, that is, the assumption that these models can appraise and provide an understanding of the examined reality. In fact, these models denied its evolutionay nature. In this sense, McNulty argued: "That perfect competition is an ideal state, incapable of actual realization, is a familiar theme of economic literature. That for various reasons it would be less than altogether desirable, even if it were attainable is also widely acknowledged. But that perfect competition is a state of affairs quite incompatible with the idea of any and all competition has been insufficiently emphasized".445

Scholars engaged in the study of antitrust policy seldom embark on this line of research. Instead, they tend to adopt partisan views devoid of meaningful scientific interest. On the one hand, some scholars tend to endorse the policy at face value, on the basis of some form of "public interest". They are not ready to concede that the policy suffers from shortcomings in its enforcement, and they are much less willing to question whether there is in fact "public interest" justifying the policy. On the other hand, there are those who have failed to see the importance of the intellectual link from which antitrust policy emerges. Their critiques go beyond the mere postulates of a particular theory to the paradigm as a whole. They have missed the mark by aiming their objections at particular formulations within the paradigm, not at the very positive descriptive appraisal of markets conveyed by the paradigm itself, which in the end is responsible for the policy's failure to promote competition and entrepreneurship. Not surprisingly, both sides have entered into a meaningless normative discussion about the which goals the policy should focus on, instead of questioning whether the policy is useful at all. Similarly, they have dragged themselves into a futile dispute about the completeness and accuracy of empirical evidence.446

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445 P. McNulty, 'Economic Theory and the Meaning of Competition', in The Competitive Economy, Y. Brozen (ed.), (Morristown, New Jersey: General Learning Press, 1975), pp. 65-66.

446 Adams and Brock noted this in sarcastic terms: "Aficionados of the theatre of the absurd would find the character of the [antitrust] debate intimately familiar. There is an absence of communication, –a terrifying diversity of utterances, with the actors on stage listening only to snatches and fragments of the dialogue, and responding as if they had not listened at all. At times the dialogue consists of statements that are in and of themselves perfectly lucid and logically constructed but lacking in context and relevance. At other times, absurd ideas are proclaimed as if they were eternal truths. In this dialogue of the deaf, the actors are animated by the certitude and unshakeable nature of their basic assumptions -one side relying on the wisdom of past experience, the other prepared to sweep away the beliefs that have been tested and found wanting, beliefs they consider illusions and self-deceptions". (Adams and Brook, p. xii.)

Rejecting objectivism, however, should not be interpreted as a rejection of the need for objectivity in scientific inquiry.[447] Rather, it should be understood as a critique of the duplicity of the positivist appraisal, which has claimed to preserve a value-neutral appraisal while in fact it contains a clear, implicit normative bias. As Berlin indicated, if a positivist political science were in fact to become triumphant, the achievement would not be a victory for objectivity and neutrality but for a particular ideological belief.[448]

These arguments simply show the need for something more than a restatement of the current paradigm, and indeed more than a few mere amendment of the current neo-classical explanations of market behaviour. We need a new paradigm from which to derive a novel appraisal of markets and their implications. Rather than presenting new solutions, a new paradigm would force us to explore new questions, new problems and an alternative way of looking at social phenomena. As Schumpeter contends: "our argument, framed to refute a prevalent *theory* and the inferences drawn therefrom about the relation between modern capitalism and the development of total output, only yields another theory, i.e. *another outlook on facts and another principle by which to interpret them.*"[449] It would call for a taxonomy, in the words of Addleson: "the economists' meaning of competition requires a taxonomy, not a definition; and a taxonomy needs a framework".[450] Wubben is even more assertive when contending that what is needed is a new epistemology.[451] If criticising antitrust policy must begin at the epistemological level, where the relevant questions are made and the premises of the analysis are laid

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447 Loughlin, p. 34.

448 Id., p. 30. In the post-empiricist era, "there is an intrinsic connection between fact and value built into the conceptual structures that we erect and that this insight applies also to the edifice of public law we have built." (Loughlin, p. 33.)

449 Schumpeter, pp. 91-92.

450 M. Addleson, "Competition", p. 97.

451 E. Wubben, "Austrian Economics and Uncertainty: On a Non-Deterministic but Non-Haphazard Future", in New Perspectives on Austrian Economics, G. Meijer (ed.) (London: Routledge, 1995), p. 107.

down, it is necessary to define an alternative paradigm in order to understand market phenomena and competition.

2. TOWARDS A NEW APPROACH TO THE REGULATION OF MARKETS: IMPROVING FEASIBLE MARKET ARRANGEMENTS RATHER THAN ATTEMPTING TO ACHIEVE IMPOSSIBLE NIRVANA STANDARDS.

Our perception of desirable regulation depends upon our picture of reality. On the one hand, viewing competition as a structured closed-end order, where definite outcomes may be anticipated, inevitably invites us to regard policy-making and legislation as tools for influencing social order in such a way as to attempt to make it fit predetermined desired results. By contrast, understanding competition as an ongoing, open-ended discovery process whose merit rests on its very existence, rather than on its delivery of previously determined outcomes, invites us to consider policy action and legislation in a completely different way.

This was clearly noted by Schumpeter in his description of capitalism as a *Creative Destruction Process*. In his opinion, viewing markets as ongoing processes affects the analysis in two ways: "First, since we are dealing with a process whose every element takes considerable time in revealing its true features and ultimate effects, there is no point in appraising the performance of that process *ex visu* of a given point of time; we must judge its performance over time, as it unfolds through decades or centuries. (...) Second, since we are dealing with an organic process, analysis of what happens in any particular part of it –say, in an individual concern or industry– may indeed clarify details of mechanism but is inconclusive beyond that. Every piece of business strategy acquires its true significance only against the background of that process and within the situation created by it. It must be seen in its role in the perennial gale of creative destruction; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull."[452]

452 Schumpeter, p. 84.

Under a evolving-process appraisal, there is no point in identifying the optimal states to be achieved, simply because there are no such states, but just a continuous flux. According to O'Driscoll and Rizzo, it is only possible to do so with reference to the *processes* which those outcomes are the result of: "There are not competitive results unless there is competition. (...) Without competition, there is no reference point to which comparisons with real-world results can be made. In the absence of competitive markets, economic theory cannot tell us what is optimal. [Thus] competitive values or allocations do not exist 'out there,' independently ascertainable apart from actual market results".453 In fact, "there are a few abstract distinctions that can be posited about the outcomes of monopolistic as compared with competitive markets".454 The assumption that firms in concentrated markets behave "badly" or that co-ordination is creates suspicion that some despicable intention is being disguised, is a by-product of visualising reality through equilibrium models.

For this reason, as Schumpeter suggests "[antitrust] economists who, ex visu of a point of time, look for example in the behavior of an oligopolist industry (...) and observe the well-known moves and countermoves within it that seem to aim at nothing but high prices and restrictions of output are making precisely that hypothesis. They accept the data of the momentary situation as if there were no past or future to it and think that they have understood what there is to understand if they interpret the behavior of those firms by means of the principle of maximizing profits with reference to those data. The usual theorist's paper and the usual government commission's report practically never try to see that behavior, on the one hand, as a result of a piece of past history and, on the other hand, as an attempt to deal with a situation that is sure to change presently –as an attempt by those firms to keep on their feet, on ground that is slipping away from under them. In other words, *the problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them. As long as this is not recognized, the investigator does a meaningless job. As soon as it is recognized, his outlook on capitalist practice and its social results changes*

453 O'Driscoll and Rizzo, p. 143.

454 Id., p. 144.

considerably." (Author's italics)455 And later he concludes "In analyzing such [restrictive] business strategy *ex visu* of a given point of time, the investigating economist or government agent sees price policies that seem to him predatory and restrictions of output that seem to him synonymous with loss of opportunities to produce. He does not see that restrictions of this type are, in the conditions of the perennial gale, incidents, often unavoidable incidents, of a long run process of expansion which they protect rather than impede. There is no more of paradox in this than there is in saying that motorcars are travelling faster than they otherwise would *because* they are provided with brakes."456

It would be easy to destroy the delicate balance of reciprocal expectations created among market participants as a result of antitrust enforcement. Based on a contrived view of the world, and seeking to achieve impossible goals, antitrust policy entails unpredictable government intervention which runs counter to the ends sought by players within the market. It is inevitable that its enforcement will lead regulatory agencies to challenge as "unfair" what the business world would consider to be a desirable course of action, namely, the reduction of uncertainty for investments.

There is no way to distinguish the intentions of businesses because, contrary to their constitutive premises, production takes time and agents do not possess complete information about the range of prices available *if known*. The mere number of firms or other similar stationary variables cannot give any meaningful indication of their conduct. Even in crowded markets, entrepreneurs will behave as profit-maximising monopolists. Only by trial and error will they discover that the price-quantity combination maximises the profits of their competitive firms.457 The conventional paradigm is short-sighted in a literal sense because it emphasises the short-run allocation of resources to the detriment of long-run considerations of efficiency. From a long-term perspective, output restriction (i.e. limiting freedom) is not necessarily competition-reducing, but competition-enhancing. Schumpeter contends that economists misinterpret the nature of restrictive

455 Schumpeter, p. 84.

456 Id., p. 88.

457 O'Driscoll and Rizzo, p. 145.

market undertakings: "Practically any investment entails, as a necessary complement of entrepreneurial action, certain safeguarding activities such as insuring or hedging. Long-range investing under rapidly changing conditions, especially under conditions that change or may change at any moment under the impact of new commodities and technologies, is like shooting at a target that is not only indistinct but moving -and moving jerkily at that. Hence it becomes necessary to resort to such protecting devices as patents or temporary secrecy of processes or, in some cases, long-period contracts secured in advance. But these protecting devices which most economists accept as normal elements of rational management *are only special cases of a larger class comprising many others which most economists condemn although they do not differ fundamentally from the recognized ones.*"458 (Author's italics) As Hayek put it: "Competition is a sensible procedure to use only if we do not decide beforehand who will do best. It will only tell us who did best on the particular occasions; not necessarily that each did as well as he could have done".459

By challenging these expectations, antitrust enforcement inevitably closes any possibility that firms can reducing their uncertainty, which is a *sine-qua-non* condition for them to compete in seeking new information. In other words, antitrust does not promote but challenges innovation and entrepreneurship. The practical impossibility of gathering all the relevant (i.e. perfect and objective) information to identify whether competition exists on the basis of their outcomes induces us to think that the conventional paradigm suffers from serious conceptual flaws.

Why are scholars so inclined to follow the conventional appraisal, notwithstanding its obvious limitations? Perhaps this is a consequence of misunderstanding the subjective nature of information shared within the social system, which is frequently assumed to be readily available to the observer. As Kirzner explains: "We very often take knowledge for granted. Where the objective conditions exist for a gainful opportunity, we very often unthinkingly assume that all relevant parties are aware of these conditions. So we jump to

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458 Schumpeter, p. 88.

459 Hayek, Law, Legislation and Liberty: The Political Order of a Free People, pp. 67-68.

the conclusion that the gain in fact enjoyed as a result of grasping that opportunity is indeed to be attributed simply to the fulfillment of those conditions".460

By proposing an alternative view of competition, we have attempted to develop some ideas about the sort of "public interest" legislation that would promote it effectively. The essence of the new paradigm rejects the use of static equilibrium and perfect competition as heuristic tools to explain market phenomena, but neither does it conform to the dynamism of the conventional paradigm. It is evolving, in the sense that it emphasises irreversible change.

A new appraisal of the world where individuals interact, devoid of the idealistic premises laid down under neo-classical economics would give a better and richer appraisal of the rules likely to develop in the course of social interaction.461 Under such an appraisal, the goal of regulation should not be to reach some ideal optimum state, which can never be achieved, but should be to improve social co-ordination.

Understanding the substance of business activity is essential in formulating a competition policy aimed at boosting competition and innovation, which is the real task to be undertaken if Latin America is to be freed from poverty and underdevelopment. Such a policy should stress the building up of transparent institutions, which could curtail government discretion through proper judicial accountability, reinforce the arrangements

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460 Kirzner, Discovery..., p. 75. Richardson also argues, in a similar sense, that the neglect of informational aspects is due in part to a confusion of approach, which denotes "the failure to distinguish clearly between the point of view of the model builder himself and that of the creatures within the model. [Thus] for the creator, there is no problem of knowledge, for the objective facts about the system appear as postulated data from which could be deduced (or so, it was believed) the equilibrium configuration." (Richardson, Information..., p. 40.) The use of methods of analysis used in mechanics in the study of social phenomena is also responsible for this. (Richardson, Information ..., p. 41.)

461 The economic understanding of these rules is probably closer and more revealing of the complexities of social interaction than the simplicity of the models developed in the field of neo-classical "Law and Economics". An overview of the tenets of the Law and Economics discipline is found in B. Siegan, "The Interaction of Economics and The Law" in The New Palgrave: The Invisible Hand, J. Eatwell, M. Milgate, P. Newman (eds.) (New York: W. W. Norton, 1989.) A review of Law and Economic history is given in R. H. Coase, "Law and Economics at Chicago", 36 Journal of Law and Economics [April 1993], 239-254.

voluntarily undertaken by firms through contract law, and clearly define property rights over social resources in order to dispel uncertainty in the future.

In short, effective policy-making for the promotion of competition in an evolving world should aim at improving existing institutions rather than attempting to create Nirvana worlds.

The analysis developed above centres its attention on comparing imperfect (but capable of improving) institutions which governs market processes, rather than focusing on achieving impossible optimal market outcomes. These institutions embody the rules that actually affect market exchanges and the behaviour of firms when interacting with one another. Far from being pessimistic, the appraisal brings a realistic approach to the complex problems posed by social interaction, which arise from the impossibility of predicting the future with certainty in a world which is far from ideal.

In fact, it is the existence of rules and conventions that reminds us of the imperfection of the world, but they also tell us how to improve it. A comparative study of institutional settings, and the constraints they bring about with regard to incentives and information as a means of testing their capacity to achieve their goals, is a more meaningful endeavour because it offers the policy-maker an attainable task. At least, that is more meaningful than struggling with quixotic attempts to make the world resemble ideals that caricature reality and which are unachievable in the end.

Once the goal is made clear, obvious questions get asked: how does this analysis materialise in practice? And how can existing institutions be improved?

3.- The creation of a market-friendly institutional support for competition, entrepreneurship and innovation in Latin America.

The guidelines for institutional design can only arise through an alternative economic and legal research project for the explanation of social rules, which conventional legal analysis cannot undertake. Such a project involves several explanations on the behaviour of firms, currently known as "market process" theories. These theories based upon the evolutionary, post-Marshallian and Austrian schools of economic theory in the field of industrial organisation, market theory and the theory of the firm.[462]

They all emphasise the conditions neglected by conventional analysis: that markets evolve in conditions of irreversible time and disperse knowledge amongst those who interact in the social system. They also acknowledge that entrepreneurship and innovation are necessary conditions for correcting unavoidable errors committed in the light of sheer uncertainty.

Institutional rules governing market transactions enable individuals to reduce their uncertainty about the future. These rules are not devised by some enlightened authority, but instead evolve over time through a process where entrepreneurs themselves choose the rules that provide them with greater assurance about what to expect from everyone else. Similarly, these rules do not necessarily correspond with the positivistic sense of "law", whereby some enlightened ruler devises the "social good" and imposes it upon individuals from above. Rather, it is the other way round; authorities may attempt to identify the rules that provide individuals with legal certainty and predictability. The fundamental fact is that entrepreneurs will only be willing to invest and compete when uncertainty is reduced, and it is difficult to see how this can happen if the rules do not have the consent of those who are supposed to comply with them. This is particularly relevant in weak institutional settings such as Latin America, where effective enforcement is always compromised.

The Latin American development experience consistently shows a clear connection between economic underdevelopment and a lack of institutional certainty in political and economic institutions. Latin American governments may actively promote competition by reinforcing the web that keeps their institutions functioning, thus reducing the uncertainty

462 A summary of the literature on evolutionary economics, post-Marshallian and Austrian schools of economics is found in N. Foss, "Austrian and Post-Marshallian Economics: The Bridging Work of George Richardson", in Economic Organization, Capabilities and Co-ordination, Routledge, London, 1998.

for individuals about the business environment in which they trade. Trade restrictions emerge from government action, seldom from business practices. In this respect, Jatar argues that while the policy in the United States evolved as a Government reaction to the formation of monopolies, in Latin America the policy is justified insofar as it challenges previous *anti-competitive* behaviour encouraged by Governments themselves.[463]

There are clear links between the stable and predictable institutional framework achieved by a system where the rule of law and Economic Freedom prevails and economic development.[464] The erosion of the rule of law and the subversion of economic freedom by unwarranted "public interest goals" declared by public authorities seldom, if ever, favours economic development.

That regulators seldom perceive this fact reveals their proclivity to be haunted by their own agenda, which is not necessarily in line with the "social good", and which is based on very dubious epistemological grounds.

The next question, then, is how to improve institutions? How can one build such predictability and legal certainty? The answer involves the notion of "accountability". In short, antitrust policy, like any other, must be accountable.

Unaccountable administrative discretion diminishes the predictability of private entitlements to social resources. As a result, either public officials or (in the absence of an effective institutional framework) powerful private parties tend to appropriate these "gaps" in the entitlements of social resources. The crucial aspect of all this is that it

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463 See A. Jatar, Competition Policy in Latin America, p. 4. She adds: "Decades of paternalism in Latin America contributed to build an institutional and legal structure which is in clear conflict with competition standards. Thus for the institution responsible for promoting competition in a recently liberalized economy, deregulating the economy and opposing past and present governmental action, which may collide with competition principles, becomes a major issue". (p. 14.)

464 See J. Gwartney, R. Lawson and W. Block, Economic Freedom of the World: 1975-1995, The Fraser Institute et al., Vancouver, 1996. For a recent empirical reappraisal of this question, see H. Grubel, "Economic Freedom and Human Welfare: Some empirical findings", 18 Cato Journal, (1998): 287-304.

affects, not only the "misallocation" of rights, but also introduces uncertainty into the market system, which inhibits all attempts to foster innovation and new ideas. However, in the case of antitrust policy it may be necessary to note that such judicial accountability may prove elusive due to its nature. A rule-of-reason analysis, whereby antitrust authorities attempt to distinguish "anticompetitive" from "efficient" limitations on competition, cannot provide any clear guidance, since it is made with reference to a standard ("social efficiency") that has little to do with the intention behind the undertakings actually entered into by real firms; in the end, the vagueness of this standard invites the enforcement agency to impose its own ethical views on social policy.

Such policy standards are not accountable, as they represent the utilitarian view of whoever is in charge of enforcing the policy. It is no wonder that judicial and administrative decisions have traditionally been so erratic when deciding whether a restriction should be regarded as prohibited *per se* or subject to a "rule-of-reason" analysis. Rothbard contends that finding monopolistic restrictions depends on the particular arbitrary definition of competition and monopoly adopted: "It is vain, however, to call simply for a clearer statutory definition of monopolistic practice. For the vagueness of the law results from the impossibility of laying down a cogent definition of monopoly on the market. Hence the chaotic shift of the government from one unjustifiable criterion of monopoly to another: size of the firm, 'closeness' of substitutes, charging a price 'too high' or 'too low' or the same as a competitor, merging that "substantially lessens competition,' etc. All these criteria are meaningless".465 In his opinion, there are no monopolistic prices, but only free-market (i.e. unhampered) prices.466

Following similar considerations, Letwin underlines the subtle problems surrounding every antitrust determination in the realm of legal theory: "(...) even in a simple economy many other problems would arise in interpreting the simple antimonopoly law. Granted that if any one man quickly bought up all ten of the community's cloth

465 Rothbard, Power and Market: Government and the Economy, (Kansas City: Universal Press Syndicate, Inc., 1970), pp. 60-61.

466 Rothbard, "Monopoly...."

shops he would obviously have violated the law –that is, the intent to monopolize might fairly be inferred from his behavior, unless he could prove some other intent– still, what if some man acquired only five of the ten? Judges might then reasonably disagree as to how the law should apply: while some will contend that in prohibiting an end result the law implicitly prohibits steps toward it, others will assure that if the law implicitly prohibited any act that might lead to an unlawful result the laws would be safeguarding the public at the cost of paralyzing it. If a man known to hate his mother-in-law buys a rope, has he or has he not gone far enough on the road to murder so that the law should stop him? Has the buyer of the five of the ten cloth shops come close enough to monopolizing to be stopped by the law?"467

Ultimately, such accountability will depend on the prevailing legal culture subjecting these interpretations to effective judicial control. The underlying principles of the legislation could impose more effective limitations on the encroachment of individual rights than written constitutions. In this regard, there is a new breed of constitutionalism emerging in Europe, which offers a promising outlook for the development of a more effective protection of individual property rights from government encroachment.468

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467 W. Letwin, Law and Economic Policy in America: The Evolution of the Sherman Antitrust Act, (Chicago: The University of Chicago Press, 1965), p. 6.

468 See, Lon. L. Fuller, "Positivism and Fidelity to Law - A Reply to Professor Hart", 71 Harvard Law Review [1958], pp. 630-672; also, U. Everling, "El Tribunal de Justicia de las Comunidades Europeas como Tribunal Administrativo", in La Justicia Administrativa en el Derecho Comparado, (Madrid: Civitas, 1993), pp. 647 et seq. For example, Germany has attempted to develop a more ambitious judicial review. There, the emergence of the theory of "essence of rights" is an attempt to provide more effective protection. This theory is complemented by efforts to control the interpretation by public authorities of non-legal terms (e.g., "competition", "relevant market", "dominance", "market power"). These terms should be interpreted in accordance with *social conventions*, not at the whim of the judge. However, the way in which economic theories pervade "social conventions" (as expressed by statutes) and their influence over the appraisal adopted by judges when deciding legal cases is not clear. In other words, the legal doctrines developed to protect individual rights from government encroachment still only afford limited protection of rights in reality because they do not challenge the paradigm that supports conventional regulation. Indeed, understanding the interaction between legal and economic theory is a fairly recent concern in Europe, compared with the development of Law and Economics in the United States. Consequently, the pace of judicial control in these countries is still uneven and sometimes dominated by formalism. This is the case, for example, in the French judicial review of administrative acts. As argued by Everlin, "In France the Public Administration enjoys a considerable margin of appraisal... the courts seem to let themselves become influenced by the allegations of the Public Administration, presuming that it has appraised properly the relevant facts. And of course, they do not review those facts which require a technical or economic analysis". (Everlin, Id., p. 648.) European

Perhaps the proliferation of "amparo" cases (literally, "constitutional protection") and similar injunctions against government action, based on these legislative measures, is an expression of a renewed concern for protecting individual economic rights in the region.[469]

Boettke's solution to this dilemma, then, is to isolate markets from the political manipulations that prevent them from materialising: "In order to correct the situation –to chart a new course– economic forces must be unleashed from political forces, even if those political forces are democratic. The main failing of previous policy can be found in rules of the game which perverted the incentives to actors to discover and use economic information effectively. Competition among alternative market experiments is the best way to assure that new ways to satisfy market demand are discovered and that power is divested from any single entity in society".[470] In other words, it is necessary to set up reliable impartial institutions that offer an effective defence of economic rights, which constitute the very legal foundation of economic activity, and hence competition.

Therefore, institutional reform in Latin America should not be regarded as a matter of mere quantitative calculations as to the effect of the elimination of trade barriers and privileges that impede trade and competition. Although it is true that these reforms have succeeded in fostering trade and investment opportunities by reducing overseas investment costs and enhancing the availability of foreign technological inputs. These factors, coupled with the reduction or elimination of government impediments to trade, such as tariffs, domestic discriminatory rules, non-tariff barriers and the like, have notably unshackled the economies of reforming countries by introducing competition.[471] Some

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scholars highlight the diversity of national jurisdictions with respect to judicial control; as an ex-judge of the European Court of Justice argued: "it is in this area particularly that national interests show their differences". (Lord Mackenzie Stuart, The European Communities and the Rule of Law, The Hamlyn Lectures, Stevens and Sons, London, 1977, p. 64.)

469 Brewer, Judicial...,

470 Boettke, Why Perestroika ..., at 108.

471 For an up-to-date review of international economic developments see Trade and Development Report, 1994, UNCTAD Secretariat report, New York, 1994. This study analises the impact of recent developments in trade on developing countries.

progress has been made in this respect and international organisations are today acknowledging the need to consolidate the reforms achieved through long-term institutional reform.[472] Today, more emphasis is placed on the institutional elements that determine development: the assignment of property rights, and the importance of effective judicial and settlement agencies.

A clear vision of the essence of regulation that could guide institutional reform is still missing. In this account, it is more important to focus on the challenges to change rather than endorsing old views about "market functioning failures". It is here that resistance is to be expected from vested interests. It entails the difficult and challenging task of making the political commitments needed to ensure that the reforms initially undertaken to allow greater freedom (deregulation, privatisation, open trade) do not collapse under the weight of inherited inefficient traditions, organisational backwardness, and private rent-seeking behaviour.[473] It involves a qualitative analysis that is often full of subtleties and complexities which hinder its accomplishment.

Particular attention should be paid to the web of informal arrangements that have developed in Latin America to deal with the uncertainty of the "official" setting, and the ubiquitous unaccountable discretion that has always characterised government intervention in private affairs in the region.

Subtle forms of market co-operation have emerged, which were created to avoid the uncertainty which government intervention and political instability in the region constantly created for businesses. For example, extensive distribution channels, the presence of strong family ties in business operations, and widespread vertical integration are characteristic of Latin firms, and the procurement of special conditions which ensure the predictability of transactions illustrate their special concern with eliminating the inefficiencies of the official setting.

472 See, for example, Holden and Rajapatirana, Unshackling....

473 Naím, Latin America's..., pp. 8-17.

If any lesson is to be drawn from the Latin American experience, it is that despite the alleged effects of Latin American market concentration, *dominant firms are not necessarily powerful* (whatever that may mean). On the contrary, "the multidivisional business enterprise certainly has its place in Latin America and some of the region's largest firms provide examples of management innovation; however, unlike the United States, they are not the most powerful institutions in the region's economy. Accordingly, local models of best management practice must draw on a wider variety of organizations".474

The problem, therefore, is not one of market structure, but of preserving reliable expectations to invite entrepreneurs to invest, and thus, to compete.

4.- Final considerations.

The purpose of this work has been to initiate a discussion on what kind of intervention Latin American governments should undertake to reinforce their recent market reforms. In the process of adapting their rules and economies to increasing economic interdependence and market mechanisms, developing countries must be aware of the consequences of the antitrust policies they are currently implementing.

This is a discussion which revolves around an analysis of social institutions and qualitative government intervention in market functioning. We have chosen antitrust policy as a case for examination because it clearly shows the divergence between what is claimed and what is achieved by public policy. Antitrust aims to enhance competition; but in fact it is conceptually designed to redistribute resources among individuals in society, according to the Pareto efficiency standard or other alternative political standards of wealth redistribution. Its results are disappointing, therefore, as the redistribution of resources by definition not only creates an undesirable interaction between policy-making and politics, but also hinders market functioning, innovation and economic growth, which can only be achieved through competition and business rivalry.

474 Dávila and Gómez, p. 674.

For this reason, rather than expressing a true market commitment, the introduction of antitrust policy in Latin America shows that the new *ethos* brought about by the institutional reforms is far from reaching a definition, and that old fashioned ways of policy-making are at least dormant, if not yet reborn. Perhaps the lesson to be learned is that institutional reform in Latin America may require much more than the introduction of straightforward measures aimed at setting up new regulatory agencies throughout the region. It may require a change in the philosophy that inspires the policy which underlies them.

In the rather pessimistic words of Veliz: "Despair and perplexity seems to be the most obvious consequences of attempting to reform, modernise, revolt or transform Latin American countries in one way or another. I am convinced that this is a result of erroneously believing that the experience of Western European industrialised countries and the interpretative models arising from their experience are applicable on the peoples of the southern regions of the New World. I am also convinced that the proliferation of authoritarian regimes a few years ago it is not a moral or political oddity but the expression of a style of political behaviour, a secular inclination of Latin American society which, under varied forms –of which the military may well be the most transient one will endure in our region for a while."[475] Similar caveats could be made with reference to other areas of social life, particularly the regulation of economic activity.

The problem described above has tremendous significance for economic reform in developing countries, which is currently the focus of a debate on the nature and extent of government intervention under a new generation of institutional reforms. In this work, we have shown that antitrust does not share the implicit logic of these institutional reforms in Latin America. Instead, it reflects the misconception that economic theory can be used without limits to understand social phenomena, leading to perverse implications for public

475 Veliz, p. 15.

policy. Godek has put it very simply: "Worrying about antitrust issues shows an unhealthy anxiety about the imagined ills of capitalism".[476]

476 P. Godek, "One U.S. Export Eastern Europe doesn't need", International Merger Law, September 1991, p. 3.

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